FEDERAL COAL LEASING AMENDMENTS ACT OF 1982

HEARING

BEFORE THE

SUBCOMMITTEE ON
ENERGY AND MINERAL RESOURCES

OF THE

COMMITTEE ON
ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

SECOND SESSION

ON

S. 2704

A BILL TO AMEND THE MINERAL LANDS LEASING ACT OF 1920, AND FOR OTHER PURPOSES

AUGUST 3, 1982

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FEDERAL COAL LEASING AMENDMENTS ACT OF 1982

TUESDAY, AUGUST 3, 1982

U.S. SENATE,
SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES,
COMMITTEE ON ENERGY AND NATURAL RESOURCES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:10 a.m., in room 3110, Dirksen Office Building, Hon. John W. Warner, presiding.

Present: Senators Warner and Murkowski.

Also present: Roger Sindelar, counsel; D. Michael Harvey, chief counsel for the minority; and Linda Mason, professional staff member for the minority.

OPENING STATEMENT OF HON. JOHN W. WARNER, A U.S. SENATOR FROM THE STATE OF VIRGINIA

Senator WARNER. Today the Senate Energy and Mineral Resources Subcommittee will consider S. 2704 which would amend certain provisions of the 1976 coal leasing amendments to the Mineral Lands Leasing Act of 1920. At a time when America is facing an energy shortage, it is imperative that this Nation maximize the production of energy resources only in a reasonable and responsible manner as it relates to the environment.

With these objectives in mind, I look forward to receiving today's testimony on S. 2704, how this bill meets or does not meet this standard.

Our first witness will be the Honorable Garrey Carruthers, Assistant Secretary, Land and Water Resources, Department of the Interior.

This bill, S. 2704, has been introduced by the distinguished Senator from Alaska, Mr. Murkowski, who also, of course, is a member of the Senate Energy Committee.

We welcome you this morning, Mr. Secretary.

[The text of S. 2704 follows:]

II

97TH CONGRESS
2D SESSION

S. 2704

To amend the Mineral Lands Leasing Act of 1920, and for other purposes.

IN THE SENATE OF THE UNITED STATES

JUNE 30 (legislative day, JUNE 8), 1982

Mr. MURKOWSKI introduced the following bill; which was read twice and referred to the Committee on Energy and Natural Resources

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A BILL

To amend the Mineral Lands Leasing Act of 1920, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That, except as otherwise expressly provided, whenever in this Act an amendment is expressed in terms of an amendment to a section or other provision of the Mineral Lands Leasing Act, the reference shall be considered to be made to a section or other provision of the Act of February 25, 1920, entitled "An Act to promote the mining of coal, phosphate, oil, oil shale, gas, and sodium on the public domain" (30 U.S.C. 181 et seq.).

SEC. 2. Section 2(a)(2) of the Mineral Lands Leasing Act (30 U.S.C. 201(a)(2)) is amended by striking subparagraph (A) in its entirety and striking the subparagraph designation "(B)".

SEC. 3. The last sentence of section 2(d)(1) of the Mineral Lands Leasing Act (30 U.S.C. 202a(1)) is amended by striking out the comma after "operator" and inserting in lieu thereof "and" and by striking "and be contiguous".

SEC. 4. Section 2(d) of the Mineral Lands Leasing Act (30 U.S.C. 202a) is amended by striking paragraph (2) in its entirety and redesignating paragraphs (3), (4), (5), (6), (7), and (8) as paragraphs (2), (3), (4), (5), (6), and (7), respectively.

SEC. 5. (a) Section 7(a) of the Mineral Lands Leasing Act (30 U.S.C. 207(a)) is amended (1) by redesignating the text of subsection (a) of section 7 of such Act as paragraph (1), (2) by striking the period after "terminated" and inserting in lieu thereof ", except as provided in subsection 7(b).", and (3) by adding at the end thereof the following new paragraph:

"(2) Upon application to the Secretary of the Interior, a lessee can dedicate any lease to the production of synthetic fuels. For leases so dedicated, the period for achieving production in commercial quantities shall be extended to fifteen years. As used in this paragraph, 'production in commercial

quantities' can be satisfied by the initiation of construction of a synthetic fuels facility. Such dedication shall be terminated upon application by the lessee at any time, or upon a determination by the Secretary at the end of the fifteen-year period that the lessee is not proceeding in good faith to produce synthetic fuels from the lease. In the event of termination of the dedication, the extension provided herein shall also terminate, except that if termination occurs after the tenth year, the lessee shall pay advance royalties as provided in subsection (b) for that period from the end of the tenth year to the date of termination.".

(b) The second, third, and fourth sentences of section 7(b) of the Mineral Lands Leasing Act (30 U.S.C. 207(b)) are amended to read as follows: "Upon application by the lessee, the Secretary of the Interior, unless he determines that the public interest will not be served thereby, shall suspend the condition of continued operation or the requirement of production in commercial quantities or any requirement for production as constituting diligent development, upon the payment of advance royalties. Such advance royalties in lieu of continued operation shall be no less than the production royalty which would otherwise be paid and in lieu of production in commercial quantities or production constituting diligent development shall be at a rate equal to 1 per centum of the recoverable lease reserves. The aggregate number of years

for which advance royalties may be accepted on any lease shall not exceed ten.".

(c) Section 7(b) of the Mineral Lands Leasing Act (30 U.S.C. 207(b)) is amended by striking the last sentence in its entirety.

(d) The first sentence of section 7(c) of the Mineral Lands Leasing Act (30 U.S.C. 207(c)) is amended by striking "and not later than three years after a lease is issued,".

(e) Section 7 of the Mineral Lands Leasing Act (30 U.S.C. 207) is amended by adding the following new subsection after subsection (c):

"(d) Due to the unique qualities of coking grade coal and the scarcity of deposits usable for cokemaking purposes, the Secretary of the Interior is authorized and directed to exempt coking coal from the requirements of diligent development and continued operation. Upon a showing to the Secretary that coking coal deposits are used or will be used in or are dedicated to the support of steelmaking facilities, such exemption shall be applicable to such coking grade coal deposits in lieu of the diligent development and continued operation requirements which would otherwise be applicable. In the event that any coal from such coking deposits is used or sold for other than the metallurgical purposes, such exemption from the requirements of diligent development and continued operation shall no longer be applicable.".

STATEMENT OF HON. GARREY E. CARRUTHERS, ASSISTANT SECRETARY, LAND AND WATER RESOURCES, DEPARTMENT OF THE INTERIOR; ACCOMPANIED BY DAVID RUSSELL, DEPUTY DIRECTOR, MINERALS MANAGEMENT SERVICE

Mr. CARRUTHERS. Mr. Chairman, I have with me David Russell, the Deputy Director of the Minerals Management Service, a gentleman well known to your committee, and one of our leading experts on leasing questions in the Department of the Interior.

We appreciate the opportunity to discuss several provisions of the Minerals Leasing Act relating specifically to coal. I would like to submit my testimony for the record and summarize our position quickly.

Senator WARNER. We will put your statement in its entirety into the record. Thank you.

Mr. CARRUTHERS. I will summarize our position by sections of "yes," "no," or "maybe so."

Senator WARNER. When you say summarize your position, is that the position of the Secretary of the Interior? Correct?

Mr. CARRUTHERS. Yes, sir, it is the position of the Secretary.

Senator WARNER. Thank you.

Mr. CARRUTHERS. Under "yes," we agree with section 2, which deletes from the law a provision that prohibits anyone who has held a nonproducing lease for 10 years from acquiring a lease or other leases. We would rely in this case principally on——

Senator WARNER. Mr. Secretary, you are going rapidly, and I am going to ask you to start from the beginning once again. I did not realize you had quite that much speed. I am going to mark up this bill right now.

Mr. CARRUTHERS. I will go as slow as you want if you will——

Senator WARNER. Would you go again. I am going to make notes as you go along.

Mr. CARRUTHERS. The first one, section 2, we agree.

Senator WARNER. All right.

Mr. CARRUTHERS. We believe that you can handle all of those questions with appropriate diligence requirements.

Section 3, we agree that you should eliminate the requirement that all logical mining units be contiguous. That is really a legal and economic question and not necessarily a geological question.

Section 4, which deletes the requirement that all reserves be mined in 40 years, we agree that that ought to be deleted. That is an arbitrary condition and we believe that the economics and the formation of LMU's don't follow any known 40-year cycle.

Section 5(d) we agree. We believe it takes longer than 3 years to oftentimes file one of the resource recovery plans to gather appropriate technical data.

Now, we are ready for the "noes." Under section 5(a)(2), where there is a provision to dedicate a lease to synfuels, we don't have any problem with that. We have a problem with the extension to 15 years. We don't think that is necessary, that you can accommodate this again and according to your bill, if you were to accept all of the provisions of your bill, using advanced royalty, but our biggest problem is that we want to avoid the end product regulation problem.

We view coal, although it is not, we view it administratively as leasing a homogenous product and in this stipulation we would have to monitor it as an end use.

We say "no" as well to section 5(e) on the same grounds.

Senator WARNER. Now, just a minute, let me make a note here. So you are skipping from 5(a)(2)——

Mr. CARRUTHERS. To 5(e). Both of those we say "no" to, because we would have to have a force of end use inspectors to see that all of the statutes had been meant. So we would like for you to reconsider those sections and to eliminate those proposals.

Senator WARNER. Mr. Secretary, I am going to ask you to pause for a moment. We are joined here by Senator Murkowski and I want to make certain that he has gotten the opportunity to track along with this bill here. Did you get a copy of the bill, Senator?

Senator MURKOWSKI. Thank you, Senator. I think I am up to date on section 2—or excuse me, section 5(2).

Mr. CARRUTHERS. Yes, sir. To summarize, we agree with sections 2, 3, and 4 and 5(d). We have no problem with those sections whatsoever, Senator. And then we disagree with sections 5(a)(2) and 5(e) principally because we are being asked to administer on the basis of end use and that is a very difficult proposition.

Senator MURKOWSKI. Thank you, Senator Warner.

Mr. CARRUTHERS. Mr. Chairman, the "maybe sos" are section 5(b) and section 5(c) and those are the diligence issues. We have several bureaus in the Department of the Interior reviewing the question of diligence and contrary to our usual aggressive posture, we would just quite candidly like to be wishy-washy on the diligence issue at this time.

We do, however, believe that diligence standards are essential to the credibility of our leasing program and right now we still have a rule in place that you must have commercial production of coal by the end of the 10th year. And at the moment we are staying with that rule.

That is all I have in the way of summary, Mr. Chairman.

[The prepared statement of Mr. Carruthers follows:]

STATEMENT OF GARREY E. CARRUTHERS, ASSISTANT SECRETARY, LAND AND WATER RESOURCES, BEFORE THE SUBCOMMITTEE ON ENERGY AND MINERALS, COMMITTEE ON ENERGY AND NATURAL RESOURCES, U. S. SENATE, ON S. 2704, A BILL TO AMEND THE MINERAL LEASING ACT OF 1920, AND FOR OTHER PURPOSES.

I appreciate the opportunity to be here today to discuss amendment of several provisions of the Mineral Leasing Act relating specifically to coal.

The Administration places a high priority on the development and use of coal in meeting the energy needs of the country. We agree with the sponsor of the bill that some of the provisions of the Mineral Leasing Act of 1920, as amended by the Federal Coal Leasing Amendments Act of 1976, do not allow sufficient flexibility to accommodate realistic coal development timeframes.

In effect, these provisions serve to discourage, rather than encourage, coal production. With this in mind, the Department has been studying the coal provisions of the Mineral Leasing Act with a view to making recommendations for its amendment. Our objective, of course, is a law which provides for orderly and efficient development of the coal resource, recognizing both regulatory and technological constraints.

S. 2704 addresses some of the issues in which we have a keen interest and which we have been studying in considering whether general amendments to the Leasing Act are warranted. I will discuss the Administration's views of each of its provisions.

Section 2 of S. 2704 would delete from the law the provision that prohibits anyone who has held a nonproducing Federal coal lease for 10 years from acquiring a lease or leases under the terms of the Mineral Leasing Act.

For leases issued before the Federal Coal Leasing Amendments Act, the ten-year clock started on August 4, 1976.

Companies are faced with the unprecedented and unnecessary choice of relinquishing old Interior leases in order to bid on new ones, or of holding old leases and being disqualified from bidding on new ones. Those who choose to hold valuable but nonproducing leases cannot bid for new leases, thus removing competitors from new lease sales. The 1986 effective date of this prohibition conflicts with the diligent development timing established for old leases in the just-published Department of the Interior diligence regulations. These rules would give the holders of older leases until 10 years after the next readjustment of their lease terms to initiate production.

For example, a lease issued in 1964, and readjusted in 1984, would not require production until 1994. Under current law, between 1986 and 1994 the holder of this lease, if not producing, would be in full compliance with his lease obligations, but would still be disqualified from bidding for new leases even if they adjoined the existing lease and were an important part of the mining unit. Furthermore, synfuels projects to which Federal coal is committed but which will not be producing in 1986 may collapse if the coal companies must withdraw from the projects to avoid the prohibition against acquiring new leases.

Finally, one interpretation of the prohibition against being issued "a lease or leases under the terms of this Act" is that it applies to oil and gas and other Mineral Leasing Act leases as well as coal, so that an oil company whose coal subsidiary was not producing from its Federal coal lease could not be issued new federal oil and gas leases. We believe that these effects are undesirable and strongly favor deleting this provision from the law.

3

Section 3 of S. 2704 would eliminate the requirement that all lands in a logical mining unit shall be contiguous. We support deleting this requirement. The contiguity requirement ignores the geological realities of coal deposits and is unnecessary to serve the purposes of logical mining unit formation - that the lands will be mined as a single unit by a single operator.

We believe that the problem of combining tracts separated by barriers such as rights-of-way and the like can in many cases be resolved by regulations redefining contiguity in terms of legal subdivisions, such as the Department of the Interior adopted last week, but there is no strong reason to keep the requirement in the law. Accordingly, it is appropriate to delete this unnecessary statutory provision.

Section 4 of S. 2704 would delete the requirement in the present law that all reserves in the entire logical mining unit shall be mined within 40 years. We agree that the 40 year requirement should be deleted. The incentive to form a logical mining unit is seriously compromised by the present requirement. A lessee contemplating forming a logical mining unit faces the fact that forty-year mineout means an average production rate of 2 1/2 percent a year, compared to a continued operation obligation on an individual lease of 1% per year. Because of recent fluctuations in the demand for U. S. coal on both the domestic and foreign markets, we believe a mineout requirement of 1 percent of resources per year for Federal coal leases is a more reasonable production requirement.

Furthermore, the 40 year requirement does not on its face take into account the years in which advance royalties are paid in lieu of continued operation of the leases in a logical mining unit, i.e., a lessee who pays advance royalties for ten years after initiating production is faced with a thirty year mineout requirement. This provision is especially onerous for steel industry lessees

holding metallurgical reserves, because they need long-term commitments of reserves and also need to be able to vary their use of coal from individual mines, depending on the type of steel being produced.

Section 7 of the Mineral Leasing Act, as amended by the Federal Coal Leasing Amendments Act of 1976 (30 U.S.C. §207), contains provisions which are both inconsistent and inflexible. For instance, the 1976 amendments declare that a coal lease term is for 20 years and so long thereafter as coal is produced, and that a coal lease terminates in 10 years if coal is not produced in commercial quantities. The 1976 amendments also allow an operator to pay advance royalties for a maximum of 10 years over the life of a lease, but inconsistently appear to state that production is required in every year after the 20th year in order to maintain the lease, even though the operator still has several years remaining in which he could pay advance royalties in lieu of production.

Section 5(a)(2) of S. 2704 would add a new provision that would allow a lessee, on application to the Secretary, to dedicate any lease to the production of synthetic fuels. For leases so dedicated, S. 2704 would provide that the period for achieving production shall be extended to 15 years. "Production in commercial quantities" would be satisfied by the initiation of construction of a synthetic fuels facility. While we agree with the objective of the provision, we oppose this approach because it is complicated to administer a provision based on the end use of a product. Further, we fail to understand how an additional 5 years for meeting production requirements would benefit synfuels lessees. Under the provisions of the bill, all coal lessees could pay advance royalties in lieu of production up to the 20th year. Synfuels lessees would benefit from at most 5 years less of advance royalties. These savings would not, in our opinion,

constitute much of an incentive to develop synfuels projects.

Section 5(b) of S. 2704 would amend this section to allow continuation of a lease upon the payment of advance royalties in lieu of any production obligation, whether it was "diligent development" or "continued operation" under the Department's rules. It would require the Secretary to suspend the condition of continued operation upon payment of advance royalties unless he determines that the public interest will not be served thereby. The present law gives the Secretary discretion to suspend continued operation if he finds public interest will be served thereby.

Section 5(b) of S. 2704 would also set as the advance royalty one percent of the recoverable lease reserves, in place of the present provision. The current law allows the Secretary to determine the advance royalty on the basis of a fixed reserve-to-production ratio, at not less than the royalty owed if production occurred.

Section 5(c) of S. 2704 would delete the sentence from 30 USC §207(b) which provides that nothing in that section relating to advance royalties shall be construed to affect the requirement in section 207(a) relating to commencement of production at the end of 10 years. Sections 5(b) and 5(c) of the bill would allow advance royalties to be paid, upon Secretarial approval, in lieu of any production obligation under the lease, not just in lieu of continued operation. The bill does not make clear, however, whether the advance royalty provision can or cannot be used to extend a lease beyond 20 years, because the first sentence of Section 7(a) of the Act is not amended. Section 5(b) (Lines 17 and 18) of S. 2704 seems to say that advance royalties be used to extend a lease; however, the bill does not expressly treat this uncertainty in the existing section 7(a).

Subsection 5(c) of the bill simply conforms other existing provisions to the primary change in the bill -- that production is not required by the tenth year.

We have problems with the current diligence requirements. However, we still have questions about the proposed amendments we have not endorsed here and have initiated a review of the likely economic impacts and other effects of the proposed changes. Although we are not comfortable with the strict ten-year production requirement for new leases, we are still debating the appropriate substitute. Further, we are not yet ready to endorse restricting advance royalties to a fixed rate of one percent. We will be in a position to report back to the Congress on these diligence issues soon.

Section 5(d) would delete the time requirement - three years - within which a lessee shall submit an operation and reclamation plan to the Secretary for approval. We concur with this amendment. Interior's regulations have severed this 1976 requirement from the reclamation permit application required under the Surface Mining Control and Reclamation Act of 1977. Experience has shown it to be very difficult for an operator to do all the work necessary for permitting a new mine (hydrologic studies and the like) and to file a complete SMCRA plan within three years.

Finally, section 5(e) of S.2704 would add a new subsection to the law that would exempt coking coal from the requirements for diligent development and continued operations, leaving it subject only to the requirement to produce annually after 20 years, or under section 5(b), to pay advance royalties instead. While we agree with the objective of this provision, we oppose this approach because as we mentioned earlier in connection with leases dedicated to synfuels projects, it is complicated to administer a provision based on the end use of a product. In addition, much coal that can be blended for coking can be used as steam coal.

11-283 O—82——2

We also point out that S.2704 does not say how or whether the revisions to the diligence provisions of section 7 of the Act will apply to existing leases. This is an important issue which is left unresolved by the bill. There are several alternatives. The bill could say that it applies prospectively only; or it could apply to all leases but give the lessee the option to stay under its present lease; or it could apply to all leases including those issued prior to enactment of S. 2704, whether or not they have been readjusted since the Federal Coal Leasing Amendments Act of 1976.

Our recommendation is that the law should clearly spell this out. Subject to our earlier statement that we cannot take a position at this time on diligence, we believe section 7 of the Leasing Act - however it is revised - should become applicable to all leases issued or readjusted after August 4, 1976.

The Department will continue to review the diligent development issue, as well as a variety of other technical changes to the Mineral Leasing Act, in conjunction with Members of the House and Senate, and their staffs. We hope changes like those proposed here can help reduce unnecessary or burdensome provisions, without sacrificing the benefits that result from the 1976 Coal Amendments and other leasing laws.

We would be pleased to work with you and your staff in further developing appropriate amendments.

This concludes my statement. I will be pleased to answer questions.

Senator WARNER. Mr. Murkowski, would you like to initiate the questions or do you have an opening statement?

STATEMENT OF HON. FRANK H. MURKOWSKI, A U.S. SENATOR FROM THE STATE OF ALASKA

Senator MURKOWSKI. Thank you, Mr. Chairman. I appreciate your accommodation. I do have an opening statement. I want to thank you for scheduling this legislation for a hearing on short notice.

Earlier in the year it came to my attention and to others that there were serious concerns over some of the provisions of the Federal Coal Leasing Act of 1976, which altered the provisions of the Mineral Leasing Act of 1920. These concerns seemed reasonable and I considered the proposing amendments that you have rectified so we can perceive the problem.

In the House a bill had already been introduced, has already been introduced and after hearings were held, I felt even more strongly that the Senate should consider the changes that have been incorporated in S. 2704. I therefore introduced it several weeks ago in general in the same form as the House, which drew approval from those testifying in the House on June 10.

There are seven different proposals in the bill, the key one, in my judgment, is the repeal of section 3 of the FLICA passed in 1976. That provision requires those holding leases as of August 1976 produce commercial quantities of coal by August of 1986 or would be ineligible for bidding on any other oil and gas or mineral lease.

I think this is shortsighted and ill-advised. I have also added to the bill some language to give synfuel producers a longer period of time to get coal leases into production. It is still evident to me, Mr. Chairman, that we are evidently going to need synfuel production in this country and we would be foolish not to encourage such projects where and when we can.

Of course, my intention here is to assist those truly working to produce coal for synfuel production and the amendments make it clear that the use of the additional time for other purposes would be penalized. Mr. Chairman, I do not mean to underemphasize other provisions of the bill but point out the two that I see as the most significant.

Of course, I am not insistent on the language of the legislation and I hope the witnesses we have here today will tell us how we can improve the provisions included. It is my intention to give lease holders a fair chance to develop their leases under realistic conditions and guard against those who would take advantage of the use and obligation.

I believe we have a duty in the Congress to make sure the people of this country get a fair price for the minerals owned by the Government and that the leasing grounds are used for the purposes intended.

While I would be among the first to make sure that the private industry gets a fair shake, I will also demand that they act in good faith and not engage in speculation at the public expense.

I thank you, Mr. Chairman, for that accommodation. I have one question, if I may.

Senator WARNER. Yes, indeed.

Senator MURKOWSKI. You indicate, Mr. Carruthers, in your statement that you will report back to the Congress on your suggestion for changes in the diligence development requirements. Could you tell us when we can expect to have these recommendations?

Mr. CARRUTHERS. We have not established a time frame on that, Senator. It is a complex issue, involving the Solicitor's Office, Minerals Management Service, some relationships with the Department of Energy, and I just can't give you a firm date on that.

Senator MURKOWSKI. Can you give us a ballpark framework?

Mr. CARRUTHERS. November 30.

Senator MURKOWSKI. That is pretty good. We will take that.

Senator WARNER. If the Senator would yield on that question. There was some discussion we heard that you had represented, not necessarily you, but someone, to the House of Representatives that you would have it by the 30th of June.

Mr. CARRUTHERS. Yes, sir. Mr. Chairman, I testified before the House and Congressman Santini asked me to express to him my concerns about the diligence issue by the end of the month and we spelled out in a brief letter to him some of the concerns we have about how to achieve diligence and I can make that a part of the record, if you would like, sir.

Senator WARNER. Yes, we would like to have that as part of the record.

[The letter follows:]

United States Department of the Interior

OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20240

Honorable James Santini
Chairman, Subcommittee on
Mines and Mining
Committee on Interior and
Insular Affairs
House of Representatives
Washington, D.C. 20515

JUL 21 1982

Dear Mr. Santini:

In response to questions raised at the June 10, 1982 hearing on H.R. 5895, we have prepared for your review an expression of concerns with respect to the diligence and exemption provisions.

Diligent development and related issues of continued operations and advance royalties, are essential elements to the effective management of this Nation's vast supply of publicly owned coal resources. The premise from which we propose greater private sector opportunities to explore for and develop federally administered coal resources contains four prerequisites to leasing:

1. Comprehensive land-use planning.

2. Thorough environmental assessment.

3. Fair market value return to the public for resources sold.

4. Requirements to develop leases diligently.

Free-market forces, if allowed to guide development decisions, can ensure timely development of leased reserves. However, for purposes of program credibility and in the interest of maintaining sharp levels of competition, certain minimum requirements for timely development and operation of leased Federal coal estate have been established. Certain of these provisions in the Mineral Leasing Act of 1920 (MLA), as amended by the Federal Coal Leasing Amendments Act of 1976, are overly restrictive, inflexible, and in need of revision to prevent economic dysfunctions such as reducing competition.

The conditions precedent to passage of the 1976 amendments have significantly changed. Federal coal production has doubled, adverse speculation has been curbed, new laws, such as the Surface Mining Control and Reclamation Act, have been implemented, and new regulations have been imposed. The Department continues to study carefully the coal provisions of the MLA to identify outdated and inflexible sections needing revision. Our joint objectives, of course, are to provide for orderly and efficient development of Federal coal resources consistent with stringent environmental safeguards, while insuring that we do not impose overly restrictive production requirements which serve only to escalate the price of coal to energy consumers.

Deputy Dir., MMS

The Department supports the provisions of H.R. 5895 that would delete (1) the prohibition against acquiring any other mineral lease if one has not achieved production in commercial quantities on a previously issued coal lease; (2) the requirement for contiguity of lands within a logical mining unit (LMU); (3) the 40-year mineout requirement for an LMU; and (4) the 3-year requirement for submittal of the operations and reclamation plan.

The revised coal operating regulations which are now pending will establish the Department's policy on diligence in compliance with the existing law. In its deliberations, the Congress may wish to consider a myriad of approaches to the coal diligence question. For example, consideration should be given to the financial and market incentives available to encourage lessees to diligently develop the coal resource, the economic impact on energy consumers, the regulatory aspects of implementation, the restrictions and fiscal impacts on industry, and the cash flow to the U.S. Treasury. Consideration should also be given to issues of minimum payments or advance royalties in lieu of diligence and continued operation and whether such payment should be fixed or variable, when such payments should begin and end, and what credit, if any, should be provided for payments of this nature.

With regard to categorical exemptions to diligent development, consideration should be given to administrative simplicity and discretion. One example might be to provide that exemptions could be administratively provided for coking coal, in situ gasification, synfuels, or others similarly situated if found to be in the public interest.

We share your interest in removing unnecessarily restrictive requirements from the mineral leasing statutes and appreciate your leadership on these important issues.

Sincerely,

sgd/ Garrey E. Carruthers

Assistant Secretary -
Land and Water Resources

Mr. CARRUTHERS. We did not report a recommendation to them.

Senator MURKOWSKI. With that late date, that pretty well eliminates the ability to do much this session with that portion of it.

Mr. CARRUTHERS. Senator, we are satisfied at the moment that we are unable to give our opinions, our position to you. We are satisfied at the moment of living with the diligence requirement that exists in our rules, that states that by the end of the 10th year, you must have commercial production.

We are satisfied with staying with that. We would like to take a look at a more market oriented solution to the diligence question. We are unable to meet your time frame and perhaps in that regard.

Senator MURKOWSKI. Can you tell us perhaps what type of substitute you might be considering?

Mr. CARRUTHERS. I think the substitute looks at the possibility of paying royalties, advanced royalties, and the level of those advanced royalties and over what period of time those would be permitted. And that is the principal option than we would look at as opposed to regulation. So we have not concluded that that is a better option that the one we are living with right now.

Senator WARNER. Senator, it seems to me that you and I and others have to determine whether or not this bill can, in fact, go forward, because of the, I think, necessity for some classification.

November 30, what is the magic about November 30, except that Congress will be gone home. Do you want a lameduck bill?

Mr. CARRUTHERS. No, sir. When asked to ball park it, that is a good ball park date, it struck me, and we could get the job done by then.

Senator WARNER. I defer to you, Senator. You are the sponsor of the bill.

Senator MURKOWSKI. I wonder if we might consider leaving this section and going forward with the others.

Senator WARNER. I would be happy to work with you on any alternatives.

Senator MURKOWSKI. I appreciate that in view of the time frame. Due diligence is pretty tough.

Senator WARNER. I have no further questions of the witness, Senator.

Senator, I have to open a hearing of the Armed Services Committee at 10 and I am wondering if you might chair in my absence.

Senator MURKOWSKI. I would be very pleased to, Senator.

Senator WARNER. Thank you very much.

Senator MURKOWSKI [presiding]. The next witnesses represent a panel group, Mr. Richard Mr. Holsten, Jr., president Pittsburgh & Midway Coal Mining Co.; Charles Dietrich, senior counsel, Utah International, San Francisco, representing the American Mining Congress; and Mr. Thomas Lloyd, attorney, United States Steel Corp. and secretary of United States Steel Mining Co., Inc, Pittsburgh, representing the American Mining Congress.

If you gentlemen would approach the witness table please. Mr. Holsten, I believe you are at the top of the panel list. Would you please proceed. We welcome you to the committee and wish you a good morning.

STATEMENT OF RICHARD M. HOLSTEN, JR., PRESIDENT, PITTSBURGH & MIDWAY COAL MINING CO., DENVER, COLO., ON BEHALF OF THE NATIONAL COAL ASSOCIATION

Mr. HOLSTEN. Thank you, Mr. Chairman. I am Dick Holsten, president of the Pittsburgh & Midway Coal Mining Co. of Denver and also vice chairman of the National Coal Association. With me are Mr. Dietrich of Utah International, San Francisco and Mr. Lloyd of United States Steel, Pittsburgh.

As background, P & M is a major coal producer, stretching from southern Appalachia through the Midwest into the Far West. We are also major holders of Federal coal leases, some of which we have in production, some of which are waiting for production, and, of course, normal mining events, and a large portion of which are not in production, much of which we have already engineered and we are just waiting for markets.

On behalf of the three of us, we appreciate very much the opportunity to appear before you and testify in favor of Senate bill 2704. From the standpoint of the coal operator, in reading the bill, it appears to me that the bill contains very narrow, very precisely drawn language that would amend the 1976 act in a way that would make Federal coal leasing more effective than it presently is.

In particular the bill addresses the problem of section 3 and the diligent development section, section 7. With your permission, I would submit my remarks in writing to you and then summarize the rest.

Senator MURKOWSKI. It will be so submitted for the record.

Mr. HOLSTEN. I think I would like to start by making an observation, again, from the perspective of a coal operator, that the proposed changes contained in 2704 affect only the terms and conditions of coal leasing. They do not in any way represent a change in the environmental protection aspects of coal mining, nor do they in any way circumvent the responsibilities that we as operators have for environmental protection, both during and after mining.

Likewise, the legislation is in no way a retreat from the 1976 act and it is not construed in our minds any way as a change of the general position taken by Congress in 1976. I think any attempt to bring either environmental considerations in or aspects or change of intent vagues the issues that are actually before us.

What is happening and, in fact, what has happened, is that conditions have materially changed. Conditions in the coal industry have materially changed since 1976 and as a preface to our recommendations, I would like very briefly to relate what has happened leading up to the 1976 amendment that subsequently has changed.

The granddaddy, I guess, of all of this, as you mentioned, the 1920 Mineral Lands Leasing Act, which established the disposition of minerals, coal included, would be by lease rather than by patent. However, between 1920 and, say, maybe 1960 or a little after, there was actually very little Federal leasing activity principally in the West for the reason that there was very little coal activity, very little demand for Western coal in this period.

However, starting in the mid 1960's, the outlook for coal in general brightened and if you were at that particular time a forward-

thinking, aggressive individual, I think you would have to say that the outlook for Western coal was blossoming also.

I use the word outlook, because it really was not until almost 10 years later that production began to catch up with this optimism. It was not until the mid 1970's that Western coal production as a whole began to increase, both in response to economic changes in the Western areas and outside stimulus such as the Clean Air Act and the importance of low sulfur coal and also at that time the general hysteria on the emergence of OPEC.

But prior to the mid 1970's, anywhere from 5 to 10 years prior to the mid 1970's, you had the growth and leasing activities. In fact I read somewhere that during the period 1965 to 1970 there were more Federal coal leases issued than in the entire 40 or 45 years going back to 1920.

All of this produced concern both within the industry, within the administration and within Congress about what was happening, particularly the degree of speculation that might be taking place in these coal leases.

The result was several things occurred in the 1970's. The first of which was an administrative action, Mr. Morton's moratorium, which effectively terminated coal leasing for 10 years. The second thing that happened was that there started a national debate within Congress that resulted in the enactment of a whole series of laws, one of which was the 1976 Federal Coal Leasing Act amendments.

These amendments did solve some of the Western coal leasing problems but they also created others which now need to be rectified. In this regard, I think I would like to make three general observations. First, since 1976, Congress has passed a whole series of laws in addition to the Federal Coal Leasing Act amendments, which address concerns, earlier concerns.

Among these there would be the Federal Land Policy Management Act of 1976, which addresses land management activities. There was the Surface Mining Control and Reclamation Act of 1977, the Clean Air Act amendments of 1977, which addressed the control of the environmental responsibilities.

All of these have directly affected coal leasing decisions, be they made by industry or be they made by speculators. The second point I would like to make is since 1976 the Western coal market itself has changed. Low cost, environmentally acceptable Western coal is now a major factor in the coal industry. In 1970 something in the order of less than 10 percent of the Nation's coal was in the West. Today about a third of it comes from the West.

In 1970 less than 2 percent of the Nation's coal was Federal. Today more than 10 percent is Federal coal. The point being that Western, in particular Federal coal specifically is growing and will continue to grow in the future. It is important to the industry what is happening in the West.

The third point I would like to make is that the 1976 act has accomplished its goal of eliminating the interest of speculators. It has done this very simply by making leasing competitive. It has eliminated the prospecting permit approach to leasing, which is where the speculators got into the act for very little investment.

The act also makes it far more difficult for a lessee to hold coal without bringing it into production, so-called diligent development. A combination of the two, the economic penalty for getting in and holding coal and the forced development of coal has eliminated speculation.

There are two problem areas that we now foresee from the standpoint of coal producer in the 1976 provisions. They are designed to enforce the lease end of production. The first is section 7 of the 1920 act that requires new leases not producing in commerical quantities at the end of the 10th year to be terminated, the diligent development.

The second is the section 3 which deals with the existing leases at the time in 1976 and it bars the issuance of any further minerals lease after 1986 if you don't have your leases in production.

The section 7, diligent development provision, are not only inflexible but they do not recognize the real world problems associated with the time that it takes today to bring Western coal into development. Section 3 today is totally unnecessary. Both provisions are misdirected. Both are counterproductive. Both penalize the legitimate coal producer rather than the speculator. And neither are required to achieve the goals for which they were enacted.

The amendments set out in your bill will remedy the most serious of these problems and we fully support them. Section 3 should be repealed and section 7 amended. With regard to section 3, I think a point that is often overlooked, and also with regard to section 7, is that in order to bring a lease into production, you first have to have a market. The cost of building a coal mine with all its infrastructure runs into the hundreds of millions of dollars.

And you just simply cannot economically afford to do it without a market. However, it is hightly unlikely at the time that you are bidding on a Federal lease that you actually do have your market. You get the lease first. You then find your market. The market comes along sporadically. When the market does come along, you have to have the lease in hand in order to have costed it out, figure out what your price is, and only then if you are competitive you get the order and then you enter into production.

But you have to have the lease first and then you go through all of the time it takes to find and develop your market, to get your environmental permits, which is a lengthy time, to build your coal mine and go into production. Ten years is a very, very short time for this.

Mr. Dietrich will address that in greater detail and all I would like to do is fully support both the repeal of section 3, which is unnecessary, and the modifications of section 7, which will give more flexibility to an operator in coping with his legitimate effort to put a coal mine into operation as soon as he has a Federal lease.

At this point I would like to ask Mr. Dietrich if he would address section 7 in more detail.

[The prepared statement of Mr. Holsten follows:]

NATIONAL COAL ASSOCIATION

Testi ony

Of

Richard M. Holsten, Jr.

President,

Pittsburg & Midway Coal Mining Company

On Behalf Of

The

National Coal Association

On

S. 2704

To Amend The Mineral Lands Leasing Act Of 1976

Before The

Subcommittee on Energy and Mineral Resources

Of The

United States Senate Energy And Natural Resources Committee

August 3, 1982

Washington, D.C.

Mr. Chairman and members of the Committee. I am Richard M. Holsten, Jr., President of Pittsburg & Midway Coal Mining Company. I am appearing today on behalf of the National Coal Association. Also representing the coal industry today are Mr. Charles Dietrich, Chairman of the American Mining Congress's Leasing Committee and Senior Counsel for Utah International Inc. and Mr. Thomas Lloyd, Counsel for the United States Steel Corporation, and Secretary of U.S. Steel Coal Mining, Inc.

With your indulgence, Mr. Chairman, our presentation will be made in several parts. I will review the background which has led to several present problems with the Mineral Lands Leasing Act (as amended by the Federal Coal Leasing Act Amendments of 1976), focusing, in particular, on the two which are most pressing and serious. Mr. Dietrich will discuss, in detail, the needed amendments set forth in S. 2704 and will present comments and examples developed by AMC and NCA supporting the need for such amendments. Mr. Lloyd will address Section 5(h) of S. 2704 which would exempt metallurgical coal from the "diligent development" and "continued operations" requirements of the Mineral Lands Leasing Act.

The National Coal Association (NCA) and the American Mining Congress (AMC) jointly represent most of the nation's major coal producers as well as companies involved in the transportation and distribution of coal.

Mr. Chairman, we believe that the narrowly drawn amendments to the Mineral Lands Leasing Act set forth in S. 2704 must be enacted to make the Federal Coal Leasing Program effective.

Recognizing the concerns of the Department of the Interior (DOI) and Congress, the coal industry is not proposing a retreat from the general positions embodied in the Federal Coal Leasing Act Amendments of 1976.

Moreover, the issue before you today is not an environmental one. The issue is coal leasing, not the environmental effects of coal mining or the planning process for Federal coal leasing. Nothing in this bill affects the production and reclamation

requirements of the Surface Mining Control and Reclamation Act of 1977 nor the land use planning requirements and procedures set forth in the Federal Land Policy And Management Act of 1976. The narrowly drawn amendments contained in S. 2704 deal with the terms and conditions governing Federal leases. A Federal lease does not convey an automatic right to mine nor can production take place until all environmental, mining and reclamation permits are in hand.

I. INTRODUCTION

A. Western Coal Has Become a Major Component of National Energy Production.

Western coal production and, in particular, coal production from Federal lands, has risen dramatically in recent years. Access to large amounts of low priced Western coal is providing the competition necessary for limiting the growth in national energy prices. However, about 80 percent of Western coal reserves are owned or controlled by the Federal government, and collectively the Mineral Lands Leasing Act and the regulations governing the leasing of the Federal coal are critical factors affecting whether and at what rate most Western coal is produced.

B. Certain 1976 Amendments to the Mineral Lands Leasing Act Are Unnecessary And Are Causing Problems With Respect To Present And Future Western Coal Production.

In the years since the enactment of the Federal Coal Leasing Act Amendments of 1976 (the 1976 Amendments or FCLAA) to the Mineral Lands Leasing Act, the coal industry has been heavily involved with development of the various sets of complex and highly technical regulations set forth by the DOI in its several attempts to implement the FCLAA. Moreover, the industry has been developing a great deal of valuable experience with respect to the realities of Western coal production and marketing.

Based on this involvement and the better understanding of Western coal production and marketing, the industry, upon careful reflection has determined that certain provisions added by the 1976 Amendments: (1) are unnecessary; (2) impact the wrong parties; (3) could cause serious disruption to Western coal development both with respect to particular producers and the West in general; (4) may fail to achieve the goals for which the provisions were enacted; and finally, (5) may foster, to a certain degree, the problems the 1976 Amendments were designed to cure.

C. The Amendments Set Forth In S. 2704 Remedy The Most Serious of These Problems.

The limited amendments to the Mineral Lands Leasing Act which are encompassed in S. 2704 in the short term are critically necessary to orderly Western coal development and, in the longer term, will result in the goals of the FCLAA being achieved more effectively.

In brief, these amendments:

1. delete the prohibition (set forth in Section 3 of the FCLAA) on issuing leases for any leaseable mineral to anyone who has held a federal coal lease for 10 years without producing coal in "commercial quantities" on that lease;
2. allow payment of advance royalties to meet "diligent development" requirement, in addition to meeting the requirements of "continued operation" as is now allowed in the law, but retain the 10-year restriction on the aggregate number of years for which any advance royalties may be accepted;
3. delete the requirement that logical mining unit (LMU) plans require exhaustion of reserves in 40 years;
4. delete the "contiguity" requirement for logicial mining units;

5. continue the requirement to submit a mine plan to the U.S. Geological Survey, but not within 3 years of lease issuance as currently required;
6. add a special coking coal provision which would recognize that coking coal has unique qualities which may require exemption from the rigid requirements of "diligent development" and "continued operation;" and
7. add a special provision granting leases dedicated to synfuel projects 15 years, rather than 10 years, to meet "diligent development" requirements.

To place the current discussion on coal leasing in perspective, we believe it would be useful, to consider the background of the issue prior to discussing the needed amendments.

II. EVENTS LEADING TO THE 1976 FEDERAL COAL LEASING ACT AMENDMENTS.

A. The Basis for the Previous System.

Prior to the 1976 Amendments, the statutory authority for leasing Federally owned coal was contained in the Mineral Lands Leasing Act of 1920 (subsequently amended), and certain related statutes applicable to acquired lands. That Act provided, among other things, that the disposition of certain mineral interests, including coal, was to be accomplished by lease instead of patent grant of fee title to land. Leasing was in two forms:

1. Competitive bidding — but only in areas where coal deposits in workable quantities were known to exist, called "known coal resource areas" (KCRAs) as determined by the U.S. Geological Survey; and
2. A non-competitive system — on lands everywhere outside KCRAs. As part of this system, prospecting permits to encourage exploration were

issued. Such permits could ripen into a "preference right lease" upon application by the permittee and a showing of discovery of coal in "commercial quantities."

Leases were issued for indeterminate periods subject to "diligent development" and "continued operation" requirements, although lease terms and conditions were subject to readjustment at the end of each 20-year period. Lease terms required a royalty payment.

B. The Coal Industry From 1946 - 1960 Was In Decline; Western Coal Leasing Languished.

Although the basic law governing leasing of Federal coal lands was enacted in 1920, actual Western leasing languished for the next 40 years. From 1920 until 1960, with the exception of the war years 1941-1945, the number of leases did not exceed 20 per year, and did not exceed 40 per year until 1960. This should not be surprising. From 1920 to the post war period, coal was produced principally in the East. After World War II, the coal industry went into a steep decline. During 1947, the coal industry produced 630 million tons but by 1961 output had dropped to 403 million tons, as traditional large markets such as railroads, home heating and industrial sales slumped badly and in some cases disappeared.

Thus, low market demand provided little incentive for major industry-wide efforts to lease or develop Western coal.

C. Beginning Slowly From 1961, the Coal Industry Started to Improve and Western Leasing Increased.

Beginning in 1962, conditions for the coal industry began to improve, particularly with a rise in steel and electric utility demand and eyes began turning to the largely ignored low-cost Western reserves.

From 1961 to 1965, the number of Federal coal leases rose from about

40 per year to slighty more than 150 per year. Almost 160 were issued annually during the years from 1965 until 1970. The number of leases awarded from 1965 to 1970 approximated the total number awarded from 1920 to 1960. Moreover, the size of the leases increased almost as fast as the number during that 5-year period.

More and more, serious producers began entering the Western coal fields to prepare themselves for increases in anticipated demand. However, the actual increase in demand was only beginning to occur. For understandable economic reasons, as well the time required to put mines into production, output from leased acres did not seem to correspond to the leasing activity.

By 1974, spurred on by the Arab Oil embargo, Western production rose sharply as did the value of Western coal-bearing lands. In 1970, Western production was 51 million tons, of which 12 million tons were from Federal lands. By 1976, Western production was over 136 million tons, 55 million tons coming from Federal leases — a 350 percent increase in Federal coal compared with 1970. Leases issued in the 1960s provided the resource base for this rapid increase in production and acted as a brake on price increases in the post-embargo era. Interestingly, the mine-mouth price of coal increased only 6 percent in real terms from 1975 to 1980 while national production increased about 40 percent.

D. Concern About "Speculation," Lack of Adequate Land Use Planning, And The Environment Lead the Department of Interior To Impose A Moratorium on Federal Leasing In 1971.

In 1970, DOI became concerned about three different issues, all of which directly or indirectly affected leasing: (1) the discrepancy between the the production potential of its leasing and the actual production from its lands; (2) land use planning and, in particular, planning the use of

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"irretrievable national resources"; and (3) environmental effects of various Federal legislative and regulatory actions. An informal moratorium was instituted on all coal leasing and two years later that moratorium was formalized, except for leasing needed to prevent a mine from closing or where reserves were needed for production in the near future. Under this policy, DOI issued only 13 coal leases or lease readjustments and modifications over the next four years. For all practical purposes, all other coal leasing activity during this period simply ceased.

At the same time this limited short-term policy was initiated, the Department began work on an environmental impact statement (EIS) analyzing a new coal program. This EIS, which was begun in early 1973, and not completed until September 1975, was successfully challenged in court in 1977. The program was rewritten and it was not until January 19, 1981 that the federal government began to lease in any major way — almost 11 years from the initiation of the moratorium.

It was within this context that Congress, in 1975, began the process which led to the enactment on August 4, 1976 of the Federal Coal Leasing Act Amendments.

III. THE 1976 FEDERAL COAL LEASING AMENDMENTS - PARTLY A SOLUTION AND PARTLY A PROBLEM.

A. Congressional Concerns In 1975 - 1977

Concerned about the same issues with which the DOI had been wrestling since 1971, Congress enacted the FCLAA. Congress subsequently enacted a series of statutes that further dealt with the concerns.

- First, to remedy the "planning problem" with respect to Federal lands and resources, it enacted the "Federal Land Policy and Management Act of 1976" (FLPMA);

- Second, to remedy the perceived environmental problems associated with surface mined coal, it enacted the "Surface Mining Control and Reclamation Act of 1977" (SMCRA). It also enacted, The Clean Air Act Amendments of 1977 (CAA). Its "prevention of significant deterioration" provision, in addition to existing clean air and water statutes, NEPA and the "Endangered Species Act" - affected coal mining to varying degrees and substantially altered the circumstances surrounding Congressional concerns in 1976.

As the Senate Committee on Energy and Natural Resources, stated in its summary of the history which led to the enactment of the FCLAA, stated:

> "(the) mechanism (of obtaining an exploration permit which could ripen into a "preference rights lease") was used extensively by legitimate coal companies to obtain coal on the public domain and by a small number of mine developers and "market makers" to speculate with large areas of Federal coal lands. Congressional concern over these speculative abuses led to the passage of the Federal Coal Leasing Amendments Act of 1975." (Emphasis added.)

Moreover, in particular, the Committee stated:

> "The act addressed the problem of speculation by requiring the termination of any lease which is not producing in commercial quantities at the end of 10 years."

However, fundamental changes in the market for Western coal during the 1970s combined with enactment of a number of provisions in the FCLAA and other laws, have provided ample protection against speculation.

B. The Marketplace Has Changed Since 1970.

As Table I indicates, in 1976 total Western production reached 136 million tons or 20 percent of total U.S. coal production. Of this, production of

federal coal reached 54 million tons or 8 percent of total production. In the ensuing years, Western coal output has increased to 268 million tons or 33 percent of total output. But more importantly, production from Federal lands reached 82 million tons or 10 percent of total production. These numbers show that Western coal both privately and publicly owned is not only being developed but will represent an increasingly significant percentage of future U.S. production as it expands to meet new demands.

C. The Conditions Which Contributed To The Speculation Were Beginning To Be Cured By The Time The FCLAA Was Enacted.

Three conditions contributed to speculation in Federal leases in the late 1960s: (1) the previously discussed upturn in general demand for coal which foreshadowed a market for Western coal, but which by its very slowness acted to retard rapid production of leases; (2) the low costs of acquiring leases under the system of prospecting permits; and (3) the failure of the USGS to map on a large scale the "known coal resource areas".

By the time of enactment of the FCLAA, as noted previously, serious Western coal producers were not only leasing but beginning to produce on those leases in large quantities. Today, large scale Western coal production has greatly increased and the markets for such production have been much more solidified. As a result the value of Western coal lands has risen dramatically.

In addition, the USGS had stepped up it mapping activities of the known recoverable resource areas, thus drastically reducing the amount of land available to be leased by non-competitive means.

Thus, to a certain extent, the FCLAA was attempting to solve a problem which was already beginning to be cured by changing market conditions and late but necessary administrative action.

D. The FCLAA Contained a Number of Amendments Which Eliminated The Interest of True Speculators In Further Entering The Leasing Market.

The 1976 Amendments eliminated the interest of the speculators by: (1) directly or indirectly increasing the cost of obtaining a lease; and (2) making it very difficult to hold on to the land without bringing it into operation "in commerical quantities" by a date certain.

In the first category, the FCLAA, among other things:

- eliminated "preference right" leasing (except for "preference right lease applications" filed prior to enactment) and required that all leases be issued competitively;
- required all lands to be leased subject to "comprehensive" federal or state land use planning;
- required lease terms to be for an initial 20 year period (not an indeterminate period) with "readjustment" every 10 years thereafter;
- required that lease terms be set and the federal government receive "fair market value" for the leased federal coal;
- established a minimum royalty of 12.5 percent of the sale price for surface coal (although it can be lower for underground coal); and
- established no maximum royalty.

Each of these provisions, to varying degrees, raised the cost of obtaining a lease and thus reduced the number of those interested in coal leasing to those who have the capability and the will to produce coal.

Two provisions were designed to force a lease to be developed:

1. a requirement that a new lease not producing in "commercial quantities" by the end of the 10th year after issuance be terminated; and
2. a provision barring the issuance of any new MLLA lease (including oil, gas, etc.) to any coal lessee who has held a coal lease for 10 years

after August 4, 1976 without producing on such lease in "commercial quantities."

These two provisions, arguably are effective weapons against speculators but ironically their true impact has fallen on coal producers. These provisions threaten producers' existing leases, will cause instability in the coal industry and threaten needed projected federal, state and local royalties. The irony is that with the changes in the marketplace and the other provisions in the FCLAA, these two provisions are overkill. We are, in a sense, "throwing the baby out with the bath water."

The coal industry believes that the Mineral Leasing Act should be amended to eliminate the problems created by these two provisions.

IV. SECTION 3 SHOULD BE REPEALED.

Section 3 of the FCLAA amended the MLLA to prohibit the Secretary of the Interior from issuing after August 4, 1986 any type of mineral lease obtainable under the terms of the MLLA — that is, leases for coal, oil and gas, oil shale, potassium, phosphate, sodium, native asphalt, solid and semisolid bitumen, and bituminous rock — to any entity which has failed to produce coal in commercial quantities from even a single federal coal lease in ten years.

Section 3 was directed primarily at those federal leases which had been issued prior to 1976. If a pre-1976 lease fails to meet this production requirement by August 4, 1986 (10 years after the enactment) the penalty is severe — namely, the lessee holding such coal lease would be barred from obtaining any other federal mineral lease under the MLLA.

A. In Addition to Changing Market Conditions and the General "Cost-Enhancing" Provisions of the FCLAA, Two Department of the Interior Regulatory Actions Have Further Reduced The Need for Section 3.

Two DOI regulatory actions sharply reduced the need for Section 3: (1)

the institution of a leasing moratorium; and (2) adoption of effective "diligent development" requirements which are to be applied to pre-1976 leases upon the first "readjustment" of its terms after 1976.

1. The impact of the leasing moratorium.

With a leasing moratorium in effect throughout most of the 1970s, "new" leases obtained by producers came primarily from the purchase of speculators' lease rights in one manner or another. This has reduced the number of leases held by spectators.

2. Effective DOI production requirements.

Particular attention has to be paid to this second action. Prior to the FCLAA, the law's leasing production requirements were based on the concepts of "diligent development" and "continued operation." These concepts, however, were never effectively defined, developed or enforced. Since the enactment of the FCLAA, the DOI has adopted regulations fully delineating these concepts. Thus, unlike the conditions existing at the time of enactment, speculators cannot hold on to their leases indefinitely.

All this, notwithstanding, a valid question remains: given the large number of leases issued between 1965 and 1970, and that certain speculators may not have sold their leases to producers, if Section 3 is removed, what is to prevent them from holding their leases until 1995-2000 (based on "readjustment" occurring 20 years after lease issuance, and then triggering the "10 year production of commercial quantities" requirement)?

Legally, the answer is nothing because the terms of a lease cannot be altered until the "readjustment" date. As a result, this 9-14 year window would remain open.

We believe that most speculators will not hold onto their leases for

this length of time. However, we believe that Section 3 even if retained in law, may not seriously affect the speculator's ability to hold onto their lease until "readjustment." Instead, it will impose severe costs on serious coal producers, individually and collectively, and will have chaotic consequences with respect to Western coal and non-coal mineral development.

No other leaseable mineral is subject to a similar penalty for failure to achieve production. Coal production on a federal lease bears no relationship to development activities on leases for other minerals and foreclosing the ability of a coal producer to acquire a lease, is neither sound public policy nor good resource management.

B. Speculation May Not Have Been Seriously Affected By Section 3.

Section 3 may not operate to effect forfeitures, or force production, in the manner anticipated by Congress in 1976:

- The true speculator, defined in a 1977 Senate Committee on Energy and Natural Resources' report as one who "did not have the equipment or the inclination to move the coal" is not pressured by the 1986 deadline to do anything other than sell the lease by that date, and that pressure only exists if the speculator wishes to bid on other leases. Since speculators are not interested in producing, their need for further leasing to accommodate changing marketplace conditions or buyer demand for specific types of coal or for other minerals does not exist.

Ironically, the inability to participate in competition after August 4, 1986 affects only serious producers.

Thus, the full import of Section 3: (1) falls precisely on those it was not designed for — serious coal producers; (2) causes chaos and a corresponding

decline in production; (3) allows an opening for new speculators to acquire coal leases at cheap prices outside the leasing process; and thus (4) without production or the ability to re-let the leases, deprives the federal, state and local governments of royalties they might otherwise obtain.

C. The Potential Negative Effects on Coal Producers And Federal, State And Local Governments Could Be Extremely Serious.

1. Many producers will not be able to bring their mines into full production by August 4, 1986.

Many producers will not be able to bring all their present leases into sufficient production to meet the 1% commercial quantities production standard by August 4, 1986 for a number of reasons.

These include:

- the process of bringing a mine into production is so complex and time consuming that it often can take more than 10 years.
- specific coals are often sold to specific types of markets and those markets:
  - were often not expected to come into existence until after 1986, thus corporate planners could not begin development on these leases until demand was somewhat more assured;
  - in some cases, 1986 coal demand as projected in 1976, now stretched several years beyond 1986 and work on certain mines needed to be slowed down; and
  - in some cases, reserves were obtained to allow companies to adjust to changing market demands for differing types and qualities of fuel. In these cases, leases were not developed because markets didn't open in time to construct mines to meet the August 4, 1986 deadline;

- uncertainty about the various DOI regulations arising from the 1976 Amendments, SMCRA and FLPMA;
- the "go, no-go" development decisions had to be made, in most cases, just a few years after FCLAA's enactment, in a period of increasingly bad economic times and tight money. Decisions were often the result of legal pressure to develop leases to meet a totally artifical and, in many cases, an economically irrational deadline.

In order to preserve their right under the MLLA to bid on leases for any other minerals, many producers will simply relinquish these leases. Clearly, Congress did not intend to discourage true coal producers from developing the Western leases. Furthermore, Section 3 has the effect of limiting competition in coal production by forcing potential producers to withdraw from the market. This is not good energy or national policy. For all of the above stated reasons, and for the reasons to be delineated by my colleague, Mr. Dietrich, the coal industry recommends, as strongly as possible, that Section 3 be repealed.

V. THE "DILIGENT DEVELOPMENT" AND "PRODUCTION IN COMMERCIAL QUANTITIES" PROVISIONS SHOULD BE AMENDED.

Section 6 of the FCLAA amended Section 7 of the MLLA and imposed strict new production requirements for leases issued after enactment of the amendments. In essence, any lease not meeting "diligent development" production requirements at the end of 10 years after issuance shall be terminated.

A. The 10-Year Requirement Is Insufficiently Flexible To Accommodate "Real World" Conditions.

It is imperative that the statute be amended as provided in S. 2704, to afford more flexibility in meeting the "diligent development" requirements.

In today's circumstances, and for the forseeable future, an inflexible mandate to achieve full commercial production 10 years after lease issuance is extremely unrealistic. Although a 10 year period may have seemed realistic to Congress in 1976, a review of marketplace and government actions over the last six years clearly indicates that the conditions to which coal producers are subject are extremely volatile.

Mr. Chairman, there simply is no way to assure that full production will be achieved in 10 years. This not only increases the risk of producing on Federal leases, but reduces their value and hence revenues to Federal and State governments.

1. The existing law erroneously assumes an ability to make a perfect match of coal leased and coal sold at the time of leasing.

When a company bids on a lease it very seldom has a customer for that coal. The existing law's artificial timetables ignore coal-marketing problems by presuming an ability to make a perfect match of coal produced from the lease by type, qualities and amount with the coal being demanded by a real buyer, at a particular point in time. Considering the tremendous capital investment required, not to mention the effort and time of company personnel consumed, mines are not opened simply to producer coal in hopes there will be a buyer for it. Leases are inventories of coal quality, location and deliverability for potential customers. Not all these leases can be put into production immediately. With sufficiently flexible "diligent development" requirements, the marketplace will determine which leases will be developed and which will revert back to the federal government.

2. It Often Takes More Than 10 Years To Put a Mine Into Full Production.

Although all mines are different, some mines may be able to

produce the necessary amount of coal in the time legally required, but many cannot. To give some idea of what is entailed in bringing a mine into production, I am submitting a chart which lists the varyious steps. It illustrates that it often takes from 12-14 years to put a large surface mine into production.

The chart (fig. 1) by James R. Jones, Vice President of Peabody Coal Company, was prepared several years ago for a 5,000,000 ton-per-year mine. A normal large Western surface mine today averages 6-8 million tons per year. Mr. Jones' chart, lists 10 general steps for putting a mine in production: (1) assembling a mineable coal package; (2) market development; (3) environmental and related studies (which can take from 9-14 years); (4) preliminary design and machine ordering; (5) the NEPA process; (6) permits; (7) design and construction; (8) mining preparation; (9) production build-up; and (10) full production. Each of these steps contain numerous sub-steps. Delay in certain steps can cause follow-up delays in other steps.

A more current chart is being prepared and will be submitted to the Committee. It will incorporate the site specific EIS procedure now utilized in the West has led to further delays approximately one and one half years in the permitting process.

Mr. Chairman, the coal industry's experience of the last 6 years shows two things: (1) in the normal course of events, it is difficult to bring a large Western surface mine into production in 10 years; and (2) changes in market conditions and new and altered federal regulations exacerbate this problem, often making impossible what otherwise might be doable in 10 years.

B. S. 2704 Provides Flexibility With Respect To The Time It Takes To Put a Mine Into Full Production - - But At a High Price.

The statute provides that the "continued operation" requirement, which comes into effect after "diligent development" and the initial "production in commerical quantities" requirements are met, may be excused by the Secretary of the Interior in limited circumstances upon payment of advance royalties. There is no similar provision which would excuse the requirement of achieving "diligent development" within 10 years of lease issuance or "readjustment."

S. 2704, would permit the payment of advance royalties at a level of 1 percent of the lease or logical mining unit reserves for meeting "diligent development" and/or "continued operation" but for a maximum of 10 years in total for both requirements. This would afford lessees additional flexibility in achieving commercial production, but not without a substantial economic penalty, as will be discussed by Mr. Dietrich.

This provision, as set forth in S. 2704, will meet the Congressional concerns about speculation and the industry's need for greater flexibility, resulting in benefits to federal, state and local governments, as Mr. Dietrich will explain.

For all of these reasons, Mr. Chairman, we recommend as strongly as possible, that Section 7 of the MLLA be amended, in the manner set forth in S. 2704.

VI. Conclusion.

In my closing remarks, Mr. Chairman, I would like to stress that we believe that the amendments set forth in S. 2704:

1. are essential for Western coal to be produced in an orderly fashion to meet future national energy requriements;
2. are limited in scope; and
3. would not undercut the goals of the 1976 Amendments, particularly with respect to speculation.

S. 1704 will result in the goals of the 1976 Amendments being achieved more precisely and effectively.

Senator MURKOWSKI. Thank you very much, Mr. Holsten.

STATEMENT OF CHARLES DIETRICH, SENIOR COUNSEL, UTAH INTERNATIONAL, SAN FRANCISCO, CALIF., ON BEHALF OF THE AMERICAN MINING CONGRESS

Mr. DIETRICH. Thank you, Mr. Chairman. My name is Charles Dietrich and I am senior counsel for Utah International, a mining company based in San Francisco. I am appearing today as chairman of the American Mining Congress Committee on the Federal coal leasing program.

I will discuss each of the provisions in 2704 which the coal leasing committees of both the American Mining Congress and the National Coal Association support. I will try to summarize my written statement to some extent, but I would request that the entire statement be made a part of the record.

Senator MURKOWSKI. Your entire statement will be submitted for the record.

Mr. DIETRICH. Thank you. Directing our attention to section 3 of the 1976 Act, which prohibits the Secretary from issuing any type of a mineral lease obtainable under the 1920 statute—that is for oil and gas, oil shale and potassium and so forth—to anyone that has failed to produce coal from a single Federal coal lease within 10 years.

There are certain aspects of that that I think we would like to bring out. We feel that that prohibition is unnecessary and excessive. It was enacted at a time when the Congress was concerned about the low level of production from Federal coal leases and the possibility that leases were being held by speculators.

As Mr. Holsten mentioned, the situation has changed substantially since 1976 and production from Federal coal leases has risen dramatically. We believe that the effect of this prescription is not

reasonable. No other leasable mineral faces a similar penalty. Indeed, it is almost in the nature of a criminal penalty.

In addition, section 3 may not operate to force lease forfeiture, nor to cause production in the manner anticipated by Congress in 1976. If you will look at the language of section 3, it indicates that the transfer of a lease prior to the end of the 10-year period would result in the commencement of a new 10-year period for achieving commercial production.

Uncertainty about section 3 may well force large scale assignments of coal leases prior to the 1986 critical date so that lessees can preserve their ability to acquire other mineral leases. Now, this situation may open the opportunity for speculators to obtain coal leases, which would otherwise not be transferred. We strongly feel that existing leases should not be forced into either a position of forfeiture to the Federal or forced transfers on other lessees.

The pool of coal reserves in the hands of the industry represents a stabilizing influence, which is highly beneficial for maintaining an orderly and noninflationary marketplace to meet increasing demand for Western coal as it develops.

You will note that a recent report by the Office of Technology Assessment found that probably only 3 percent of recoverable reserves already leased would not intentionally be produced. We feel that the continued existence of the pre-1976 leases does not pose any threats to the environment in the sense that the Surface Mining Control and Reclamation Act of 1977 and other environmental laws will protect the environment.

Mine development is subject to governmental control and the extensive permitting processes of the Reclamation Act and State and local governments should be able to rationally plan for development. But perhaps the most important aspect of section 3 is that it is grossly inequitable with respect to its effect on coal lessees who have been making substantial, legitimate efforts to develop and market their coal, but have not been able to do so due to market conditions.

It would seem that this provision is very unfair when you consider that the lessees in that position have already been penalized by the effect of the marketplace. I just might mention to you an example from our own company's experience.

We have a coal deposit in the Dan Forest Hills area in Colorado, consisting of four different properties. We have a Federal lease which was obtained in about 1970. We have a State lease which was obtained at about the same time and a fee lease. We also have an application for a Federal preference right lease which was filed at the same time we obtained the Federal lease, which we hold.

Because of the moratorium, we have only recently been able to acquire that Federal preference right lease. So there was a period there around 10 or 12 years when we could not complete the formation of the logical mining unit, if you will, which was necessary to put together a minable and marketable reserve.

Yet, this provision, forgetting for a minute that we were not up to the 1986 date, but this provision if it is extended further would have prevented us from marketing the—excuse me, it would have caused a loss of the Federal lease which we already have due to circumstances beyond our control.

Turning to the diligent development requirements, which was addressed in section 5 of 2704, we believe that it is imperative that the statute be amended to afford more flexibility in meeting diligence requirements. In today's circumstances a mandate to achieve commercial production within 10 years of lease issuance is extremely unrealistic from the lessee's standpoint. Although this period may have seemed proper in 1976 a number of things have changed since that time as mentioned by Mr. Holsten.

I think we should note that the proposal to change the statute, which is embodied in 2704, would permit the payment of advanced royalties at a level of 1 percent of the lease or logical mining unit recoverable reserves for either diligent development or continued operation but only for a combined total of 10 years for both requirements.

Now, the effect of this is only to extend the present provision of the statute, which permits the payment of advanced royalties to satisfy the continued operation obligation for lessee. It permits the extension of that to cover the initial diligence requirement.

And I think it should be noted also that there is inherent in this a loss of flexibility from the standpoint of the lessee with respect to his operations later on. Because if he has paid advanced royalties to satisfy part of his initial diligence requirement that will remove some of his flexibility if he later is forced to shut down the operation with respect to his satisfying the continued operation requirement.

We also feel that you should consider the monetary advantage to the State and Federal governments from this change proposed in the bill. The economic benefits of the proposed process should be far more beneficial than the effects on the Government associated with the forced termination of leases under the present statute.

Under the proposed change, the Federal and State governments would be assured of advanced royalties if the leases were not actually producing at the end of 10 years. Under the present system no moneys will be received when the leases are terminated at the end of 10 years unless after the considerable delay and the administrative costs of running the lease land back through the administrative leasing procedure, they were again put up for sale.

And even if they were then leased, the new lessee would have a further 10-year diligence period before there would be an assurance of any money coming into the Federal Government.

One other point, which I think should be mentioned with respect to the applicability of these proposed changes in diligence to existing leases and which is not really addressed in the bill itself, it is our recommendation that the legislative history should reflect that the changes embodied in S. 2704 are intended to apply to pre-1976 leases after their effective date of readjustment and that they should not be interpreted to require the immediate payment of advanced royalties upon readjustment.

The flexibility of the advanced royalty concept should come into operation after the expiration of the 10-year diligent development period following the readjustment of the pre-1976 lease. In addition, Mr. Chairman, we would recommend that the flexibility and the diligence requirements should be afforded to lessees who have had their leases either readjusted or issued since the Coal Leasing

Amendments Act of 1976. And this could simply be achieved by permitting the lessee to apply to the Secretary to apply for an amendment to his lease which would incorporate the flexibility in this bill.

Moving on to some of the other provisions in the act, with respect to logical mining units, the statute now requires that all lands in a logical mining unit be contiguous. In practice, this is unrealistic. Legal separations such as rights-of-way or physical separations such as oxidized areas or areas where surface erosion has carried away portions of a coal seam or pinch-outs of coal seams destroy contiguity.

We think that the change in 2704 in effect would leave it up to the discretion of the geological survey to determine what was realistic with respect to a logical mining unit either from an economic or geologic standpoint makes much more sense.

The provision that any mining plan with respect to a logical mining unit require that the reserve be mined out within 40 years is also terribly unrealistic. There is no other leaseable mineral that is subject to such a forced extraction requirement. We can't think of any reason why today when powerplant life expectancy exceeds 40 years and coal supply contracts also may exceed that limit that there should be such an arbitrary timeframe.

In our own company's experience where we furnished fuel supply to two powerplants in the four corners area of New Mexico, our fuel contracts are for a term of 50 years. Another aspect of this, there are certain instances where a coal lease may contain both surface minable and underground minable reserves. We ourselves have such a situation in the Craig area of Colorado.

In that instance, the surface mining operation must be concluded before the underground mining operation can begin. And a 40-year mine-out time is just not realistic, to say nothing of the bust-town aspects of this provision which seemingly would require the shutdown of an ongoing operation after it has been running for 40 years when possibly it could run for a much longer time.

Moving to the provision in the statute which would require the submission of an operation reclamation plan within 3 years after lease issuance, such a plan cannot really be designed in any detail until the lessee has a major coal customer, because his mining plan will need to be tailored to provide for the customer's needs.

The requirement seems to be superfluous because of the requirement in the Reclamation Act that a mining plan be submitted before a mine can be issued a permit. The deletion of the 3-year requirement would permit the lessee to submit both plans simultaneously. We think this is an unnecessary provision.

Moving to provisions of subsection 5(a)(2) of S. 2704 related to production of synthetic fuels, we offer no views with respect to the merits of that provision. We should emphasize, Mr. Chairman, that the other provisions of this bill, which I have discussed, are urgently needed to maintain a healthy Western coal industry.

The problems addressed need early correction because of critical investment decisions which depend on their solution. Because the relief afforded by this legislation we feel is needed without further delay and there is apprehension that the additional syn-fuel provision might encumber or delay the enactment of this bill.

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There was a division of opinion in our joint committee considering the bill with regard to the syn-fuel provision, but it was the feeling of the majority of the committee that this provision could be such an encumbrance that would delay passage.

I would now turn this over to Mr. Lloyd of United States Steel to address the provisions regarding coking coal.

[The prepared statement of Mr. Dietrich follows:]

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on behalf of the

AMERICAN MINING CONGRESS

before the

Energy and Mineral Resources Subcommittee

of the

Committee on Energy and Natural Resources
United States Senate

on

S. 2704

A Bill to Amend the Mineral Leasing Act of 1920

August 3, 1982

AMC STATEMENT ON S. 2704

Mr. Chairman and members of the Committee. My name is Charles Dietrich. I'm senior counsel for Utah International Inc., a mining company based in San Francisco, California, and I'm appearing today as chairman of the American Mining Congress Committee on Coal Leasing.

As Mr. Holsten previously noted, I will discuss each of the provisions in S. 2704 which the coal leasing committees of both the American Mining Congress and the National Coal Association support. However, Mr. Lloyd of U.S. Steel will discuss in greater detail and answer questions with respect to the coking coal provision in subsection 5(e). We believe that this bill will provide important relief to the coal industry operating on federal lands from certain excesses which crept into the Federal Coal Leasing Amendments Act of 1976. We also feel that the changed conditions in the western coal industry strongly recommend the adoption of these changes.

In the years following the enactment of the Federal Coal Leasing Amendments Act of 1976 (FCLAA), the industry has developed a great deal of valuable experience with respect to the realities of western coal production as well as the marketing of western coal. It is from this vantage point of increased experience that we would like to discuss certain of the provisions of S. 2704. As previously noted, Mr. Lloyd of U.S. Steel Corporation will address the "coking coal" provision.

THE SECTION 3 PROSCRIPTION

A portion of Section 3 of the 1976 Federal Coal Leasing Amendments Act prohibits the Secretary of the Interior from issuing any type of mineral lease obtainable under the terms of the Mineral Lands Leasing Act of 1920--that is, leases for coal, oil and gas, oil shale, potassium, phosphate, sodium, native asphalt, solid and semisolid bitumen, and bituminous rock--to any entity which has failed to produce coal in commercial quantities from a single federal coal lease within ten years. S. 2704 would repeal that portion of Section 3 of the 1976 Act.

Section 3 must, however, be read in conjunction with the provisions of Section 6* of the 1976 Act which provide that a coal lease shall be for a term of 20 years and for so long thereafter as coal is produced annually in commercial quantities, but that any lease not producing in commercial quantities at the end of 10 years shall be terminated. The Section 6 provision on termination is directed at leases to be issued after 1976, whereas the Section 3 proscription was directed primarily at those federal leases which had been issued prior to 1976 and which were not producing in commercial quantities.** Although

* Section 6 of the Federal Coal Leasing Amendments Act of 1976 amends section 7 of the Mineral Lands Leasing Act.

** Regulations promulgated by the Interior Department define "commercial quantities" as production of 1% of the reserves in the lease.

pre-1976 leases will be made subject to the new requirements of Section 6 when they are readjusted. Section 3 imposes upon such leaseholders a much more stringent penalty; namely, that they must produce an arbitrary amount of coal by August 4, 1986, or be barred from obtaining any other federal mineral lease.

This prohibition in Section 3 is an unnecessary and excessive provision which was enacted at a time when the Congress was concerned about the low level of production from federal coal leases and the possibility that such leases were being held by speculators. In 1974 and 1975, when the committees of Congress were considering amendments to the Mineral Lands Leasing Act, the country was in a state of alarm over the entire national fuel supply situation. Fuel shortages and rising costs due to the Arab oil embargo and OPEC price-setting made daily headlines. Since 1976, the situation has changed substantially and production from federal coal leases has risen dramatically due to the generally improved market for coal resulting from the rise in the price of oil as detailed by Mr. Holsten.

We believe that the effect of the Section 3 proscription is not reasonable nor rational and can have chaotic consequences if left in the statute. No other leasable mineral is subject to a similar penalty. Coal production on a federal lease bears no rational relationship to development activities on leases for other minerals, and foreclosing the ability of a coal lessee to acquire a lease for another mineral, simply for failure to develop a coal lease, is not sound public policy nor good resource management.

Moreover, Section 3 may not operate to force the forfeitures, nor to effect production as may have been anticipated in 1976. Uncertainty about diligence requirements is already affecting planning by lessees and their potential customers. Few lessees are willing to undertake the substantial expense of opening a mine without there being a market available for the coal to be produced. Moreover, the form of Section 3 indicates that a transfer of a lease would result in the commencement of a new 10-year period for achieving commercial production. Uncertainty about Section 3 may well force large-scale assignments of coal leases prior to 1986 so that lessees can preserve their ability to acquire other mineral leases. Such a situation may open the opportunity for speculators to obtain coal leases which would otherwise not be transferred. Also, a major change in ownership of such leases could exacerbate the problems of state and local governments in planning for development. Local authorities would be faced with the problem, though not insurmountable, of getting to know the new leaseholders and of ascertaining their plans. Also, the Department of the Interior will be saddled with an administrative burden in processing lease transfers.

The industry strongly feels that existing leases should not be forced into either a position of forfeiture to the federal government or a forced transfer to another lessee. This

pool of coal reserves in the hands of the industry represents a stabilizing influence which is highly beneficial for maintaining an orderly and non-inflationary market place to meet the increasing demand for western coal as it develops. A recent report by the Office of Technology Assessment found that probably only 3% of recoverable reserves already leased would not eventually be produced.

Moreover, the continued existence of pre-1976 leases does not pose any threat to the environment, since the Surface Mining Control and Reclamation Act of 1977 (SMCRA) as well as other environmental laws will provide environmental protection. Since mine development is subject to governmental control and the extensive permitting process of SMCRA, state and local governments should be able to rationally plan for development.

The existence of a large number of coal properties in the hands of industry ready to meet the needs of an expanding coal market will permit the mechanics of the market place to operate so that the most efficiently situated deposits will be the next to be developed. Industry feels that this is the most desirable way for development to occur and this competitive efficiency will inure to the benefit of consumers everywhere. Government control of development has not had a particularly distinguished history in other parts of the world.

Finally, and perhaps most important, Section 3 and other arbitrary diligence provisions have the most inequitable impact upon coal lessees who have been making substantial and legitimate

efforts to develop and market the coal from their leases, but who have not been able to do so, or have not been able to produce in the amounts defined as "commercial quantities". We suggest that such lessees, having already been penalized by the operation of the marketplace, should not bear the further penalty of this unusual statutory provision. Many lessees in this situation may well feel compelled to litigate the issue.

For all these reasons we support section 2 of S. 2704 which would repeal section 2(a)(2)(A) of the MLLA, as amended.

DILIGENT DEVELOPMENT REQUIREMENTS

The second major area addressed in the legislation is that which deals with the requirements of diligent development and continued operation and is addressed in section 5 of S. 2704.

Section 6 of the 1976 amendments imposed strict new production requirements upon leases issued after enactment of the amendments and, as mentioned earlier, upon pre-1976 leases which are later readjusted. Section 6 mandates that any lease not producing in commercial quantities within ten years be terminated, and conditions the continuation of leases upon "continued operation" of the mine. Interior Department regulations define "commercial quantities" as 1% of lease reserves and "continued operation" as production of 1% of reserves each year. The statute provides that "continued operation" may be

excused by the Secretary of the Interior in limited circumstances upon the payment of advance royalties, but there is no similar provision which would excuse the requirement of achieving production in commercial quantities within ten years of lease issuance.

We believe that it is imperative that the statute be amended to afford more flexibility in meeting diligence requirements. In today's circumstances, and in the foreseeable future, an inflexible mandate to achieve commercial production within 10 years of lease issuance is extremely unrealistic from the standpoint of the lessee. Although a 10-year period may have seemed realistic to Congress in 1976, a number of things affecting the prospects for coal development have changed in the succeeding six years. There have been several new federal and state statutes enacted affecting both coal miners and coal consumers. The Surface Mining Control and Reclamation Act of 1977 requires an extensive permitting process and there has also been passage of numerous state and local zoning and industrial citing laws. The Clean Air Act and its "prevention of significant deterioration" aspects have affected the potential for western coal development. The application of new regulations relating to endangered species, archeological clearances and other environmental requirements have increased the complexity and extended the lead time of establishing a mine as well as industrial facilities using coal. In addition, the coal market has been changed by a slow down in the demand for new electric generating facilities, the increased ability

of the public to conserve oil and gas, a surge in interest in coal conversion, followed by a slowdown due to institutional and legal problems, and the new statutes providing for deregulation of rail rates raising costs to consumers and affecting demand. All of these changes have introduced uncertainties in the market place for coal and yet the provisions of the 1976 Act are inflexible with respect to the requirement of production from a federal coal lease.

The proposed legislation would provide some much-needed flexibility to the requirement of diligent development to those who are making legitimate efforts to produce their leases. The payment of advance royalties is already authorized in lieu of continued operation, but limited to a maximum of ten years during the period of any lease. The proposal embodied in this bill would permit the payment of advance royalties at a level of one percent of the lease or logical mining unit recoverable reserves for either diligent development or continued operation, but only for a combined total of ten years for both requirements. This would afford lessees additional flexibility in achieving commercial production at the front end. However, this flexibility is not without a substantial economic and administrative penalty--that is,a limitation on use of advance royalties for a shutdown after mine development has occurred. In the event that the operator, once in production, is forced to cease production, any years in which advance royalties were paid in lieu of initial diligence would be set off against the total number of ten years

for which advance royalties can be paid. This results in a loss of flexibility at the other end of the spectrum.

We feel that the substitution of advance royalty payments in lieu of a forfeiture of the lease would have substantial financial benefits to the federal and state governments, as well as to the public generally.

The federal and state governments would share equally in any advance royalties paid under this concept, in the same manner that they share production royalties, rentals and bonus monies. The economic benefits of the proposed concept should far outweigh the costs to the government associated with the forced termination of leases under the present statutory system. Under the proposed change, the federal and state governments would be assured of advance royalties if the leases were not actually producing at the end of 10 years. Under the present system, however, no monies will be received when the leases are terminated unless, after considerable delay and administrative cost, such leases were again put up for sale. In the meantime, of course rentals would be foregone and may never be recouped. Furthermore, should the lessee pay advance royalties during the entire 10-year period, not achieve production in commercial quantities and be forced to relinquish his lease, the federal and state governments would reap a windfall as they would have received royalties equal to production royalties for 10 years, yet the coal would remain in the ground, available for later disposal.

In addition to the economic benefits to government which would result under the proposed concept, the public interest

would be served by removing a large disincentive to industry to take the risk of attempting to develop public coal resources. The western coal industry is a risky and capital intensive business, and the automatic termination provision posed by the current diligent development requirements is one risk which many in the industry feel may not be worth taking.

As I have mentioned earlier, Mr. Chairman, the requirements of the 1976 Act become applicable to federal coal leases issued prior to the enactment of that act when they are readjusted. It is our recommendation that the legislative history of this measure will reflect that the provisions of S. 2704 are intended to apply to pre-1976 leases upon the effective date of readjustment. We would also recommend that the diligent development provisions of S. 2704 not be interpreted to suggest that holders of pre-1976 leases are automatically required to commence payment of advance royalties upon readjustment. The flexibility afforded by the advance royalty concept should only operate after the expiration of the 10-year diligent development period following readjustment. Further, Mr. Chairman, we would recommend that the flexibility contained in this legislation be afforded to lessees who have had their leases issued or readjusted since enactment of the 1976 Act. This could simply be achieved by permitting those lessees to apply to the Secretary of the Interior for an amendment to their leases which incorporate the provisions of this legislation.

LOGICAL MINING UNITS

The 1976 Act provided the Secretary of the Interior with the authority to unitize coal lands into "logical mining units" (LMUs) which could be developed in an orderly and economical and geologically efficient manner. An LMU may consist of federal and non-federal lands, but the statute now requires that all lands in the LMU must be contiguous, or touching. The concept of contiguity was originally intended to ensure that leases in an LMU would not be separated by great distance, so that production from one remote lease in an LMU could not be credited to other leases in the LMU to satisfy production requirements. Yet in practice, legal separations such as rights-of-way and physical separations such as oxidized or eroded areas of seams and pinch-outs, destroy contiguity. The proposed deletion of the contiguity requirement from the definition of the logical mining unit, as contained in section 3 of S. 2704, would permit the formation of LMUs in those situations where, but for the technical requirement of actual touching, it makes economic and geologic sense to mine various properties as a unit. As the definition of an LMU currently exists, however, the desired result of efficient mining may actually be frustrated by this "touching" provision.

40-YEAR MINE-OUT

The 1976 amendments also mandated that any mining plan submitted for a logical mining unit require that the reserves of the entire LMU be mined in a period which shall not exceed forty

years. We know of no other leasable mineral which is subject to such a forced extraction requirement, and can think of no logical reason why, in times when power plant life expectancies are now exceeding forty years and coal supply contracts may also exceed that limit, there should be such an arbitrary time frame associated with exhaustion of the mineral resource.

From a mine operations standpoint, the 40-year mine-out is incompatible with situations where reserves must be extracted by both surface and underground mining operations. In such situations the surface operation may have to be completed before the underground operation can begin. Moreover, in the case of coal which is mined to make coke for steel production, the 40-year mine-out would compel depletion of metallurgical grade reserves at a rate which is not compatible with the fixed volume limitations of steel plants.

The ability of western state and local governments to plan for development will be impaired by the present mine-out requirement. Local employment, production and transportation infrastructure would have to be abandoned at a much earlier rate than if the mine were permitted to operate in a more orderly fashion, without this pressure to exhaust the resource in 40 years. Furthermore, the 40-year mine-out provision could result in "bust-towns" in the West, especially where the exhaustion of the reserves in existing mines is not offset by new production of other mines in the same area. Much has been said about the "boom town" syndrome but little consideration has been given to an even sadder circumstance--the "bust town". The bust town

not only causes personal and financial distress to its inhabitants, but it also has a social cost. In addition, bust towns are by nature wasteful of existing facilities for social services, as those facilities are abandoned or fall into disrepair due to lack of use and funding. In short, the 40-year mine-out is arbitrary and disruptive and does not comport with the realities of the marketplace or the geologic realities of coal deposits. Section 4 of S. 2704 would eliminate it.

OPERATION AND RECLAMATION PLANS

A new provision was added to the Mineral Lands Leasing Act by Section 6 of the 1976 Act, which requires the submission of an operation and reclamation plan within three years of lease issuance. The U.S. Geological Survey interprets this provision to mean the submission of a plan which demonstrates that the lessee will comply with the requirements of diligent development, maximum economic recovery and resource recovery and protection. Such a plan cannot be designed in any detail until the lessee has a major coal customer, because the plan will need to be tailored to provide for the customer's needs. The lessee may well be lucky to have his exploratory work done to define the coal deposit, and often will not have a customer within three years of lease issuance. Moreover, the requirement that the plan be submitted within three years is superfluous in light of the detailed mining and reclamation plan which must be submitted under the SMCRA.

The amendment proposed in subsection 5(d) of S. 2704 only eliminates the three-year requirement of section 7(c) of MLLA, as amended. The requirement that the plan be submitted for the Secretary's approval "prior to taking any action on a leasehold which might cause a significant disturbance to the environment " remains in full force and effect. This requirement is in addition to the permit requirements of SMCRA. There is no filing deadline for a mining and reclamation plan, but that plan must be submitted in order to acquire a permit before mining operations can commence. The deletion of the three-year submission deadline would permit lessees to prepare both plans on a contemporaneous basis, after the lessee knows more about his customer's requirements and,hence,about the type of mining operation he will conduct.

SYNTHETIC FUELS LEASES

We offer no views with respect to the merits of the provision in subsection 5(a)(2) of S. 2704 relating to coal leases dedicated to the production of synthetic fuels. Let us emphasize, Mr. Chairman, that the other provisions of the bill are urgently needed to maintain a healthy western coal industry. The problems addressed therein need early correction because critical imminent investment decisions depend on their solution. Because the relief afforded by this legislation is needed without further delay, there is apprehension that this additional provision might encumber or delay the enactment of this legislation. While there was a division of opinion in our joint committee considering the bill, the majority of the committee felt that this provision would be such an encumbrance.

Mr. Lloyd of U.S. Steel will now address the provision of S. 2704 relating to coking coal.

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Senator MURKOWSKI. Thank you, Mr. Dietrich. I thought your testimony was most complete and enlightening. Mr. Lloyd.

STATEMENT OF THOMAS R. LLOYD, ATTORNEY, UNITED STATES STEEL CORP., PITTSBURGH, PA., ON BEHALF OF THE AMERICAN MINING CONGRESS

Mr. LLOYD. Thank you, Mr. Chairman. I am Thomas Lloyd, an attorney with United States Steel Corp. I am also secretary of the company's coal mining subsidiary, United States Steel Mining Co., Inc. My purpose in testifying in support of S. 2704 is to explain the necessity for that portion of the bill which would exempt coking coal deposits from the diligent development requirements of the Mineral Lands Leasing Act.

Like my predecessors, I have a more formal written statement that I wish to submit and I will try to gloss over it.

Senator MURKOWSKI. Your written statement will be submitted in the record.

Mr. LLOYD. Thank you. In order to put the coking coal exemption in perspective, I would like to point out that we estimate that out of the approximately 476 billion tons of coal reserves in the United States, only about 162 billion tons of these deposits are coking coals and out of this only about 8 percent of these coking coals occur in the Western United States.

For United States Steel's purposes, something on the order of at most 1 percent of the Western federally leasable coal deposits are cokable coal. I emphasize this point in order to make it clear that a coking coal exemption from forced development requirements will have a very small impact on diligent development. Due to the scarcity of the deposits, however, they have a great impact on Western steel production.

Coking coals have several traditional characteristics. We have defined coals with these. And, moreover, to support a steel making operation economically, we have to find these coals and these characterics in proximity to limestone deposits and iron ore deposits.

In selecting a steel making facility's location, we have to consider all of those factors and we estimate that about 300 miles is the maximum distance coal can be shipped for our Western coke and steelmaking operations. Any coal can be burned to make steam for power production. Hence any coal is potentially steam coal. Only a limited number of coal deposits are suitable for the production of coke, an ingredient which is essential in the making of steel.

Only bituminous coals are coking coals. Further, we look for coals which are low in ash, sulfur, moisture, alkali and other impurities. An ash content of less than 9 percent and the sulfur content is less than 1.5 percent are desirable characteristics. But in addition a coal's volatile matter content and stability affect its ability to be coked.

To find a coal with all of these properties, if it has the further ability to melt, fuse and then resolidify into a porous solid, we have a coal which can be coked. I say can be coked because in our experience, the most suitable Western coal deposits must be blended in order to produce an acceptable coke.

Due to volatility and other characteristics, no one Western coal deposit produces an acceptable coke in sufficient quantity to support a steel-making operation.

For example, to produce coke of acceptable strength in our Western steel, we mine coals in Colorado and Utah, and we blend those from coals from another Federal coal deposit mined by an outsider. Our coke ovens and furnaces in Utah are designed and operated to accommodate specifically that blend of coal.

The medium volatile and the low volatile matter coals, which we use in blending, are extremely scarce in the Western United States and constitute something on the order of one-quarter of 1 percent of Western coal deposits. Our investment in our Western steel operations could be drastically affected if these lower volatile matter coals are not available for blending with our own higher volatile reserves to make the coke our ovens and our furnaces are designed to consume.

The coking coal is so rare in the West that it is generally valued at about one and a half times steam coal production and that value differential shows that the highest and best use of those deposits and the best return on that for Government purposes is in metal and not steam production.

We produce coal from Federal leaseholds in Colorado and Utah and consume all of the tons mined in our steelmaking facilities in Provo, Utah. We sell none of the coal mined from these Federal leases and we currently hold two additional Federal coal leases with no plans for current production because of sufficient coking coal reserves on our active leaseholds.

This points out the intimate relationship between our Western steelmaking and Western coal mining for our purposes. As you are no doubt aware, steel production is currently at very depressed levels. Since our coke consumption is thus down, we are operating at reduced levels in our mines on Federal coal in Utah and Colorado. At our current operating level of steel production, demand for coal from our other dormant, Federal leaseholds is far in the future.

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With maintenance, assuming a market, a steel mill can be a very long-lived creature. We have blast furnaces in our eastern operations which were built before the turn of the century. In Utah, we and our predecessors have mined coal for steel production since 1925. If we were forced to exhaust our scarce reserves of coking

coal deposits, the lifespan and the investment in our steel operations would be threatened.

The provisions of continued operation in the Federal Coal Leasing Amendments Act of 1976 would force exhaustion of our Federal coking coal deposits in 40 years. To point out how this 40-year requirement does not comport with long-term steel production planning, we have been mining coking coal at our Geneva Mine in Utah for 38 years already and there are much more than 2 years of reserves left, especially at today's production levels.

We could be left with no coking coal reserves to support our Western steel production if we are forced to mine coking coal irrespective of the level of steel production. The expense of transporting Eastern or foreign coking coal could mandate that our steel production be limited to the Eastern United States where coking coals are more abundant.

In its studies of competition in the coal industry under section 8 of the Federal Coal Leasing Amendments Act the Department of Justice has always recognized that this cost of transportation helps to create a potentially separate Western coal market. This expense could doom Western steel production without adequate coking coal reserves.

Forced production of Western coking coal would probably not be salable in the East by reason of the transportation costs I mentioned. We consume about 1 ton of coal in producing 1 ton of hot metal, iron, which we use to make steel.

If we are forced to mine coking coal in excess of our steelmaking requirements, we would have to attempt to sell these scarce deposits for steam or export purposes. Because of their low sulfur content, some U.S. coking coal reserves have been used for steam production. Forced development of Western reserves would squander this scarce resource.

In addition, because of the expense and price differentials, that I have already mentioned, the cost of producing coking coal deposits may have made them attractive investments for mining purposes at coking coal prices but not at steam prices. Similarly transportation costs attendant in producing Western coking coal for export could make these coals noncompetitive. Mines would have to be closed with a loss in investment to us and jobs in the community.

Last, I would like to point out that the bill only seeks an exemption from diligent development insofar as deposits are in fact used or dedicated for use in coke making. The exemption would be retractively lost if a lessee sought to sell the coal for steam production after having used the exemption to escape diligent development. I heard some remarks here today that this might be difficult to administer and some sort of a burden. It is difficult for me to see. We envision that wherever we seek the exemption, we would have to file a declaration and that would be up to the lessee to insure that the coke was in fact used for—I am sorry, the coal was in fact used or dedicated for use in coke making.

I have also heard that there would be some problem in administering the royalty provisions. That is difficult to perceive since at the current time USGS has to administer the royalty payments and insure that the Government is getting a fair return on sales

and these would have to be reported, I assume, and I can't envision anybody else needing to be around.

I don't think you would need an army of inspectors or some such things in order to check out the coal that is going to coke production. If you put this in perspective in terms of numbers, I would guess that there are only about six producing coking coal leases in the West at this time and maybe a dozen total would be dedicated for that purpose.

It is hard to envision an army of inspectors would be needed to administer that. We believe that the diligent development and continued operation provisions of the Federal Coal Leasing Amendments Act were meant to stimulate steam coal production to replace oil and gas consumption.

As I have pointed out here today, the bill's limited exemption for coking coal will have a very small effect on any provisions in the act. Coking coal should be treated as the unique resource which it is and should not be subject to the same diligence requirements as nonmetallurgical coal.

Thank you.

[The prepared statement of Mr. Lloyd follows:]

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Testimony of Thomas R. Lloyd

Attorney

United States Steel Corporation

on behalf of the

AMERICAN MINING CONGRESS

before the

Energy and Mineral Resources Subcommittee

of the

Committee on Energy and Natural Resources
United States Senate

on

Section 5(e) of

S. 2704

A Bill to Amend the Mineral Leasing Act of 1920

August 3, 1982

Mr. Chairman, I am Thomas Lloyd, an attorney with United States Steel Corporation. I am also Secretary of the Company's coal mining subsidiary, U. S. Steel Mining Co., Inc. My purpose in testifying in support of S. 2704 is to explain the necessity for that portion of the bill which would exempt coking coal deposits from the diligent development requirements of the Mineral Lands Leasing Act.

In order to put the coking coal exemption in perspective, I would like to point out that we estimate that out of the approximately 475 billion tons of bituminous coal reserves in the United States, only 162 billion tons of these deposits are coking coals and only about 8% of these coking coals occur in the west. For U. S. Steel's purposes, something on the order of at most 1% of western federally leasable coal deposits are cokable coal. I emphasize this point in order to make it clear that a coking coal exemption from forced development requirements will have a very small impact on diligent development. Due to the scarcity of coking coal deposits, however, the exemption has important potential impacts on western steel production.

In order to explain the apparent inconsistency between the 8% and 1% figures above, let me amplify. As explained below, coking coals have, in general, critical characteristics. Moreover, to support a steel making operation economically, coals with these characteristics must be convenient to the steel production facilities which, similarly, must be convenient to limestone and iron ore deposits.

In selecting a steel making facility's location, these three factors (and others) have been considered. We estimate that about 300 miles is the maximum distance coal can be shipped, economically, for western coke and steelmaking.

Any coal can be burned to make steam for power production. Hence any coal is, potentially, steam coal. Only a limited number of coal deposits are suitable for the production of coke, an ingredient essential in the making of steel.

Only bituminous coals are coking coals. We look for coals which are low in ash, sulphur, moisture and alkali impurities. An ash content of less than 9% and sulphur content of less than 1.5% are desirable characteristics, but, in addition, a coal's volatile matter content and stability affect its ability to be coked. Having found a coal with such properties, if it has the further ability to melt, fuse and then resolidify into a porous solid, we have a coal which can be coked.

I say such coals <u>can</u> be coked because, in our experience, the most suitable western deposits must be blended in order to produce an acceptable coke. Due to volatility and other characteristics, no one western coal deposit produces an acceptable coke in sufficient quantity to support a steelmaking operation.

For example, to produce coke of acceptable strength in our western steelmaking, we blend medium-volatile coal which we purchase from another federal lessee with two high-volatile

coals we mine in Colorado and Utah. Our coke ovens and furnaces in Utah are designed and operated to accommodate the characteristics of the specific coals we use to make our coke.

These medium-volatile and low-volatile matter coals which we use in blending are extremely scarce in the western United States -- they constitute about 1/4 of 1% of western coal deposits. Our investment in our western steel operations could be drastically affected if these lower-volatile matter coals are not available for blending with our own higher-volatile reserves to make the coke our ovens and furnaces are designed to consume.

Ironically, in addition to all of the characteristics which I have already mentioned, western coking coals generally occur in thinner and deeper seams than other deposits. This makes coking coal that much more expensive. As a rule of thumb, coking coal in the west in worth about one and one-half times as much as steam coal.

This value differential clearly shows that the highest and best use for coking coals is in metal, not steam, production. We produce coal from federal leaseholds in Colorado and Utah and consume all of the tons mined in our steelmaking facilities in Provo, Utah. We sell none of the coal mined from these federal leases and we currently hold two additional federal coal leases with no plans for current production because of sufficient coking coal reserves on our active leaseholds.

This points out the intimate relationship between our

western steelmaking and western coal mining. As you are no doubt aware, steel production is currently at very depressed levels. Since our coke consumption is thus down, we are operating at reduced levels in our mines on federal coal in Utah and Colorado. At our current operating levels of steel production, demand for coal from our other dormant, federal leaseholds is far in the future.

With maintenance, assuming a market, a steel mill can be a very long-lived creature. We have blast furnaces in our eastern operations which were built before the turn of the century. In Utah, we and our predecessors have mined coal for steel production since 1925. If we were forced to exhaust our scarce reserves of coking coal deposits, the life span and the investment in our steel operations would be threatened.

The provisions of continued operation in the Federal Coal Leasing Amendments Act of 1976 would force exhaustion of our federal coking coal deposits in 40 years. To point out how this forty year requirement does not comport with long term steel production planning, we have been mining coking coal at our Geneva Mine in Utah for 38 years already, and there are much more than 2 years of reserves left, especially at today's production levels.

We could be left with no coking coal reserves to support western steel production if we are forced to mine coking coal irrespective of the level of steel production. The expense of transporting eastern or foreign coking coal could mandate that our steel production be limited to the eastern United States where coking coals are more abundant.

In its studies of competition in the coal industry under Section 8 of the Federal Coal Leasing Amendments Act of 1976, the Department of Justice has always recognized that this cost of transportation helps to create a potentially separate western coal market. This expense could doom western steel production without adequate western coking coal reserves.

Forced production of western coking coal would probably not be salable in the east by reason of the transportation costs I mentioned. We consume about one ton of coal in producing one ton of "hot metal" (iron which we use to make steel). If we are forced to mine coking coal in excess of our steelmaking requirements, we would have to attempt to sell these scarce deposits for steam or export purposes. Because of their low sulphur content, some U.S. coking coal reserves have been used for steam production in order to meet environmental emission standards. Forced development of western reserves would squander this scarce resource.

In addition, because of the expense and price differentials between steam and coking coals I have discussed, the cost of producing coking coal deposits may have made them attractive mining investments at <u>coking</u> prices but not at steam coal prices. Similarly, the transportation costs attendant in producing western coking coal for export could make these coals non-competitive. Mines would have to be closed, with a loss in investment to us and jobs in the community.

Last, I would like to point out that the bill only seeks an exemption from diligent development insofar as deposits are in fact used or dedicated for use in coke making. The exemption would be retroactively lost if a lessee sought to sell the coal for steam production after having used the exemption to escape diligent development. We believe that the diligent development and continued operation provisions of the Federal Coal Leasing Amendments Act of 1976 were meant to stimulate steam coal production to replace oil and gas consumption. As I have pointed out here today, the bill's limited exemption for coking coal will have very little effect on these provisions in the Act. Coking coal should be treated as the unique resource which it is and should not be subject to the same diligence requirements as nonmetallurgical coal.

Senator MURKOWSKI. Thank you very much, Mr. Lloyd. I want to thank you gentlemen for your general support and your analysis for the reasons for the legislation. During my remarks, my opening remarks, I made it clear that I did not want the bill to lead to greater speculation of coal leases.

While you touched upon that in some of your testimony, I am wondering if you have any suggestions in regard to this legislation that perhaps could tighten up the concern that some have on speculation of Federal coal leases.

Mr. HOLSTEN. Mr. Chairman, the market itself has tightened up on the desirability of a speculator to enter into Federal coal leases. Just the competitive leasing aspect, the broker or whatever you wish to call him 10 years ago was able to get in and obtain Federal coal leases at relatively no cost via the prospecting permit route.

Today the Federal leases have got to bring fair market value, which means that he has an upfront bonus payment of $3,000 an acre or something. So really there is nothing in it for him now.

Senator MURKOWSKI. It takes care of itself because of the competitive aspect.

Mr. HOLSTEN. Yes, sir.

Senator MURKOWSKI. In testimony given on the House side by Mr. James Cannon, executive director, Citizens for a Better Environment, I understand that he said: "Big money is still to be made from the buying and selling of Federal coal leases without producing coal."

Then he gave the example of Pacific Gas & Electric sales of Utah coal reserves and some oil for some $170, $171 million, far higher than the original $35 million cost in 1976. This sale apparently took place earlier this year and I am sure you have knowledge of this sale. Could you give us an explanation for what seems to appear to be a speculative sale?

Mr. DETRICH. Mr. Chairman, it is my understanding that a letter will be submitted to this committee for inclusion in the record of this hearing, giving more details with respect to that sale and seeming to contradict some of the indications made in the testimony on the House side. I believe it will come from Sun Oil Co.

Senator MURKOWSKI. Can you perhaps elaborate a little more on just what appears to be the speculative aspect of the differential between $171 million and $35 million?

Mr. DIETRICH. I believe, and I am just giving you hearsay, but it is my understanding that it was the sale of a mine which had already been permitted and into which a great deal of investment had already been poured. In other words, the property which was sold was not simply a leasehold interest, it was a leasehold interest on which a great deal of work had been done in the way of drilling, mining, planning, environmental studies and permits.

Senator MURKOWSKI. I appreciate that clarification, Mr. Dietrich. I think that is a satisfactory subject to receive in a letter to the committee.

As you pointed out in your testimony, since the amendments of 1976 Congress has enacted other legislation that makes it harder to move a coal lease into production. Can you give us some specifics on how legislation like the Surface Mining Reclamation Act of 1977 and the Federal Land Policy and Management Act and the Clean Air Act can impact your industry and just how long does it mean a production delay?

You touched upon that briefly.

Mr. HOLSTEN. Mr. Chairman, the major delay in bringing a coal mine into operation basically is twofold. First, you have to obtain your market. Once you obtain your market you know, if it is the case with a utility, how big the sale is, what the specifications are, the type of transportation and all of the rest of it that goes with developing a commitment to market.

Then you design the coal mine specifically for that. I am speaking of large Western coal mines on Federal coal. At that point you start through the permitting process and literally you have to get through that process far enough along the line before you start committing for the expenditure of capital to buy the equipment, in the event that something might have to change.

The permitting process varies State-by-State but would take anywhere from 3 to 5 years, really, to establish all of the baseline data necessary to establish what the base environment is and then the submission of your mining plan and your postmining restoration activities, so that almost half of the 10-year period, perhaps even greater than half of the 10-year period, would be taken up in marketing, in design, the permitting even before you start the construction phase of your mine.

Mr. LLOYD. If I might supplement that. As Mr. Dietrich pointed out earlier, sometimes the time limits are beyond your control. There is no time within which the regulatory authority has to act on all of your permanent applications and you can be left with no effective remedy to enforce that.

Senator MURKOWSKI. Let me ask a question, Mr. Lloyd. In your testimony you made reference to the fact that you had been mining your Geneva Mine in Utah for 38 years and I assume that is exempt from the 40-year law now because of the 1976 law which was enacted to make it effective. Is that correct?

Mr. LLOYD. That is correct. In addition, it is producing in excess of diligent production. I was trying to point out if we were going to try to support a facility now with a different federal coal lease, that 40-year requirement does not comport with it.

Senator MURKOWSKI. I assume that under the current law if the 40 year is passed you would give up your leasing improvements, would the government reimburse you for the development aspect associated with the mine? You would have to move your equipment out and the government would release it again. Do you know what type of scenario would take place?

Mr. LLOYD. I don't see any provisions in there for reimbursement for anything. As to releasing, there is, as we have seen before, no guarantee that the same coal would be up for lease again and even if it were, there is no guarantee you would get it and then you jeopardize your business.

Senator MURKOWSKI. I imagine your competitors would love to pick it up.

Mr. LLOYD. Some of them are here with me. I will not accuse them.

Mr. HOLSTEN. It would be awfully nice to have a fully developed mine here waiting for you to move in on.

Senator MURKOWSKI. The panel very likely commented on the aspects of the synfuel production and I assume the concern is because you feel it may delay or consequently result in the bill not moving forward. Is that the rationale?

Mr. DETRICH. We did not reach the considerations of merit of that provision.

Mr. HOLSTEN. I think you can make an argument both ways, both for it and against it.

Senator MURKOWSKI. We have heard the representative from the Interior in effect suggest that they were not in favor of the proposal, but I assume for other reasons.

Mr. HOLSTEN. I think he stated that it had administrative problems such as Mr. Lloyd referred to on the coking coals.

Senator MURKOWSKI. What is your opinion individually or collectively, what can we do to encourage the development of synfuels. This is the rational behind this and I know that the Federal Government has been in the business of spending a lot of money and some corporations have taken advantage of it.

I don't mean to assume that they would take advantage of it but in the sense of being optimistic, but by the same token nobody has been able to make any money regardless of what the government has done.

Mr. HOLSTEN. My own company, another division of it, has spent an awful lot of time on synfuels and have backed off of it at the present time solely because the market is not ready. In the foreseeable future, and I guess as foreseeable as anyone's guess, we don't see it in 10 years and beyond that we have got other places where we have to be putting limited capital resources.

So it is basically that the market will determine when synfuels will be there. Sooner or later they will be, be it oil shale, be it coal conversion or whatever.

Senator MURKOWSKI. Recognizing, of course, that the price of energy is going to dictate the development of synfuels, I guess the concern we have in the committee is is there anything that we should be doing to try and hurry up that development by making some considerations and this was one of the suggestions.

Mr. HOLSTEN. I suppose rightly or wrongly an operator today has a planning horizon of 10 years to 15 years and there are in our consideration more important aspects of your bill. And while we have nothing against the synfuels exception, I think we are more concerned with some of these others.

Senator MURKOWSKI. The representative from the Interior Department, Garrey Carruthers, the Assistant Secretary also was concerned about section 5(b), continuing diligent development. I am wondering if you have any comments on that.

Mr. DIETRICH. That is the provision which would permit advance royalties.

Senator MURKOWSKI. Advance royalties, upon the payment of advance royalties. Such advance royalties in lieu of continued operation shall be no less than the production royalty which would otherwise be paid. That is at a rate equal to 1 percent of the recoverable lease reserves.

Mr. DIETRICH. Really all we are attempting to do with these provisions which would add flexibility is to permit a marketplace to operate in a normal fashion and if there is concern over speculation, I think you might just run out some figures. And let us say there is a 100 million ton deposit with respect to a lease or logical mining unit and at the end of 10 years it is not in production, if the lessee wants to extend that diligence period, he is going to have to start paying some rather large payments of advance royalties in order to hold it.

And if you assume that the value of the coal is $10 a ton and the lease contains a 100 million tons, those payments run up to $125,000, per year. That is a pretty heavy price for a speculator to pay to hold something.

Senator MURKOWSKI. The Assistant Secretary, I gather, stated the necessity of administrative flexibility on that 1 percent. Do you have a problem with that?

Mr. DIETRICH. No. In fact, I think the way the bill is written it would not necessarily be 1 percent. We assume that it will be 1 percent because that is the figure that is in the regulations which came out on Friday to satisfy the diligent development requirement.

Senator MURKOWSKI. I want to thank the members of the panel. I think we have made a contribution of great significance in developing the record here and we do appreciate your very complete and

concise comments and testimony and we again thank you and your are excused. We wish you a good day.

Mr. HOLSTEN. Mr. Chairman, we were gratified to hear Mr. Carruther's endorsement for the majority of the provisions of the bill and we offer the full support of the coal industry.

Senator MURKOWSKI. Thank you very much. I appreciate your comments.

The next two witnesses we will address at the table, a panel. We welcome to the committee Mr. Karl Gawell, legislative representative, National Wildlife Federation, Washington, D.C. and we call Mr. Dave Alberswerth, Washington representative for the Western Organization of Resource Councils, also from Washington, D.C.

We wish you a good day and we will let you decide who wants to go first. I have copies of your statements. And I want to assure you they will be submitted in the record as written. You may proceed.

STATEMENT OF KARL GAWELL, LEGISLATIVE REPRESENTATIVE, NATIONAL WILDLIFE FEDERATION

Mr. GAWELL. Thank you, Senator Murkowski, for this opportunity to testify before the subcommittee. I will, as you noted, will allow my statement to be submitted into the record.

Coal, as I am sure you are finding, is a very complicated area to begin getting involved in.

Senator MURKOWSKI. Can you get a little closer to the microphone.

Mr. GAWELL. I would like to start with a bit of reflection that in fact what we are doing today, in fact the statements which you are hearing from the coal companies are matters which only 20 years from now, 10 years from now we will really see what the results are.

Perhaps one of the best things to do is to reflect what happens when the Congress passed the Federal Coal Leasing Act Amendments of 1976. That act was passed in response to the leasing activities of these companies in the 1960's. Prior to the early 1960's, coal leasing was not going up as expeditiously as it did during that 10-year period when large amounts of Federal coal were leased and production in fact declined over that period.

It was that period which led to charges and in fact documentation before the Congress that that large scale speculation was going on in the coal fields. The Congress over the veto of President Ford by two-thirds majority in both the House and the Senate passed the Federal Coal Leasing Act amendments, which set into force certain principles of Federal coal leasing.

Those principles were based upon the fact that the Federal Government would lease coal for production only. We were not, as Secretary Watt is now attempting to implement, leasing for reserves. And it set into place a system of regulation and a system of enforcement, which were to see to it that in fact that was what was taking place.

The proposal before this committee today S. 2704 I think you in no other way as being a supplement to the activities to the Secretary of the Interior. These proceedings with a direct and stated goal are reversing the trend and moving back the leasing to re-

serves. And he plans and has now underway actions which will lead to a tremendous glut of coal on the market.

The coal companies themselves are asking for provisions to be changed in the law which would provide them with tremendous flexibility when that coal is produced and will in fact also drive down the price that the Federal Government is going to get for its reserve, which it holds for the public.

In reviewing the proposal before us today, S. 2704, as it stands, is an unacceptable proposal and will basically overturn the Federal Coal Leasing Act amendments and return us to the period of the 1960's when the rule of thumb in the coal fields was speculation and massive oversupply.

Senator MURKOWSKI. You have concluded your statement?

Mr. GAWELL. Yes.

[The prepared statement of Mr. Gawell follows:]

STATEMENT OF
Karl Gawell
Legislative Representative
NATIONAL WILFLIFE FEDERATION
before the
Subcommittee on Energy and Mineral Resources
August 3, 1982
regarding
S.2704

Mr. Chairman, members of the Subcommittee, the National Wildlife Federation represents 4.2 million Americans who care about the wise use of our natural resources. We support the productive use of federal lands within the context of multiple-use planning and sound resource management. To those ends, we feel that Congress responded constructively and positively to widespread abuses in federal coal leasing when it passed the Federal Coal Leasing Act Amendments of 1976 (FCLAA) and the Federal Lands Policy Management Act of 1976 (FLPMA).

FCLAA provides for a sound coal leasing program, which the Federation continues to support. Strict diligence requirements ensure that federal coal leases will be brought into production within a definite time frame, and reduce purely speculative purchases of federal coal lesses. The prohibition against issuing federal leases to non-diligent lease holders provides a workable enforcement tool for the Department of the Interior. By restricting speculation, these requirements help to ensure that lessees do not profit from leasing except by producing coal and that the federal Treasury receives a fair return for the sale of the public's resources. The Act's requirements for a mine plan at the end of three years and the mine-out of the resource within forty years, provide a framework upon which land-use plans and planning by state and local governments can proceed to mitigate the impacts of coal development and coordinate the return of these lands to other uses.

The proposal before this Subcommittee today, S. 2704, would strike down many of the essential reforms accomplished by FCLAA and FLPMA. It would aid and abet Secretary Watt's plans to make a travesty of the efforts of the last ten years to integrate coal leasing into multiple-use planning and would deprive the American public of a fair return on the sale of the public's mineral wealth.

Before looking at S. 2704, it should be recognized that the Department of the Interior has already proposed regulations amending the Coal Management Program Regulations (46 FR 61390, et seq) and the diligent development requirements for pre-1976 leases (46 FR 62228, et seq.). The former of these was published as a final rulemaking on July 30, 1982 (47 FR 33114 et seq.). While I have not had the opportunity to review the final rule in detail, a cursory review indicates that it is essentially identical to the proposed rule. If it takes effect, it will begin turning back the clock to the destructive leasing policies of the 60's.

What the Administration cannot undo by regulation or discretionary action S. 2704 seeks to undo through legislation. S. 2704 would remove the teeth from diligent development requirements of FCLAA for post 1976 leases. It would eliminate the requirements for submittal of a mine plan within three years, the start of commercial production within ten years, and the mine-out of recoverable reserves within forty years. It would encourage speculation in federal coal leases by exempting from diligent development requirements so-called "dedicated" leases serving synthetic fuel plants or producing coking coal. It would add a provision allowing prepayment of minimum royalties in lieu of diligent development which would allow, if not encourage, lease holders to make profits by <u>witholding</u> production of coal.

S. 2704, if added to the already proposed changes in Department of Interior regulations, would mean that all other uses of coal-bearing lands would be held hostage to decisions of the coal lease holders. State and local governments would be unable to plan meaningfully for the impacts of development. "Boom" and "bust" cycles would be exacerbated. There would no longer be any meaningful parameters upon environmental disturbance, nor any reasonable time frame within which reclamation of strip mined lands can be expected.

S. 2704 will not encourage more coal production, nor increase employment in the coal fields, nor help consumers. Then, what are the reasons for this proposal which will wreak havoc upon the existing coal leasing program?

The reasons for S. 2704 become clear when it is viewed in light of the existing glut of federal leases and Secretary Watt's plans for additional coal leasing. Existing leases hold 16.5 billion tons of coal, which according to the Office of Technology Assessment is adequate to meet expected demand for new capacity well into the 1990's. Yet, the Secretary of the Interior is proceeding expeditiously with action on Preference Right Lease Applications which could add another 5.7 billion tons of coal to leased reserves within the next two years. The Secretary is also proceeding with a calculated program of offering massive new tracts of coal for lease. By the end of next year, the Department of Interior plans to have leased an additional 5 billion tons of coal, with additional lease sales planned in the following years.

If Secretary Watt's plans are successful, federal coal will be leased <u>now</u> which can meet expected demand for new capacity to 2010 or beyond. Unless the demand for coal far exceeds even the highest estimates, these leases will not be able to meet the diligent development requirements of FCLAA, and the coal

companies joining Secretary Watt in his coal leasing bonanza will face possible enforcement of the requirements of FCLAA by some future Secretary of the Interior.

Is there really any question why the coal speculators would like to see diligent development requirements relaxed? Why they cannot live with forty year development requirements, or a ten year requirement for start-up of commercial production?

"Everybody understands the deal: lease the coal now, as fast as possible, and hang on to it for as long as possible," a consulting geologist recently stated to the Los Angeles Times. That same source indicated that recent bidders on federal leases in the Powder River Basin were "operating on the belief that the federal government would not enforce the diligence requirements." (Los Angeles Times, July 28, 1982, "Energy Plan: What's Best for the Nations?") Of course, these companies would prefer certainty to "belief," which is what S. 2704 would provide for them.

The strict diligence requirements of FCLAA prevent even more speculators from bidding on these discount priced federal coal leases. These requirements, which were designed to prevent the widespread stockpiling of leases for speculation, may be the only stumbling block to Secretary Watt's plans to glut the market even further with federal coal leases.

o FCLAA and FLPMA require that federal coal be managed in the public interest. They require that returns to the federal Treasury from coal leasing be maximized. S. 2704 would help speculators reap profits at the expense of the taxpayer and the federal Treasury.

Karl Gawell
National Wildlife Federation
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o FCLAA sets forth the maxim that lessees should not profit from coal leasing except by producing coal. S. 2704 would allow speculators to reap profits without ever producing coal.

o FCLAA and FLPMA require that coal leasing take place within the context of multiple-use planning. S. 2704 would put an end to multiple-use planning, placing coal leasing above all other considerations and removing the parameters which make planning for environmental and socio-economic impacts possible.

The National Wildlife Federation continues to support the fundamental principles of FCLAA and FLPMA, and urges this Subcommittee to re-affirm them. S. 2704 would overturn the fundamental principles underlying sound management of the public's resources, and should be rejected in its entirety.

Senator MURKOWSKI. Thank you, Mr. Gawell. Mr. Alberswerth.

STATEMENT OF DAVID ALBERSWERTH, WESTERN ORGANIZATION OF RESOURCE COUNCILS

Mr. ALBERSWERTH. Mr. Chairman, thank you for this opportunity to appear on behalf of the Western Organization of Resource Councils. I am going to try to abbreviate my written statement, but would like the full statement inserted into the record.

Senator MURKOWSKI. It will be submitted into the record. Please proceed.

Mr. ALBERSWERTH. Before addressing the specific provisions of S. 2704, I think it is important to note that the bill has been proposed at a time of uncertainty regarding the direction of the Federal coal management program under the Interior Department.

New rule changes have been proposed and, indeed, they were adopted or published in the Federal Register, I believe on Friday, by the Department, which administratively weaken certain diligent development requirements in the existing rules. Until the consequences of these rule changes are understood and evaluated by the Congress, the coal industry and the public action on any legislative proposals which amend the Federal Coal Leasing Act amendments is untimely.

It is also noteworthy that none of the proposals contained in the bill effect any immediate problems of the coal industry. Instead the proposed legislation has apparently been designed to address some of the anticipated future consequences of the present administration's coal leasing policies.

Until those policies are fully developed and implemented and their consequences become apparent, any modification of the diligent development requirements in the manner presented here we

feel is untimely and only serves to add to the confusion and regulatory uncertainty which presently characterizes the coal leasing program.

S. 2704 should be considered by the subcommittee in the context of, first of all, the legacy of past coal leasing practices; second, current and future market conditions affecting the western coal industry; and, third, the Interior Department's proposals to change the emphasis of the Federal coal management program and weaken the diligent development requirements via rule changes.

I am going to here summarize some of the Department's proposed changes in the diligent development regulations—they are actually now the published changes—and compare them to the existing provisions or the formal provisions of the rules. Under the old rules, all leases issued prior to enactment of the Federal Coal Leasing Act amendments had to produce 2½ percent of their reserves by 1986 with an opportunity for an extension to 1991.

Under the Department's new rules production of 1 percent of logical mining unit coal reserves within 10 years of the first lease readjustment is required. Lease readjustments normally take place 20 years after lease issuance. Therefore, for example, a logical mining unit made up of leases issued in 1970 must produce 1 percent of its reserves by the year 2000 rather than 1986.

The old regulations provided that all leases upon issuance are automatically considered to be a logical mining unit or LMU. A mine plan must be submitted within 3 years of lease issuance and the 40-year mine-out clock starts ticking upon approval of the mine plan.

Under the new rules the 40-year mine-out provision commences only after a logical mining unit is formed upon request of the lessee and after the date of first production. No time limit for LMU formation after lease issuance is provided. Also if the mine plan is for an individual lease, the 40-year mine-out requirement no longer is required at all.

Therefore, a lessee could evade the 40-year mine-out provision by simply not declaring the formation of a logical mining unit. Under the old requirements any lease issued after August 4, 1976, the effective date of enactment of the Federal Coal Leasing Act amendments, must produce 1 percent of its reserves within 10 years of issuance.

Under the new rules any lease issued after August 4, 1976 and included in a logical mining unit, which includes leases issued prior to enactment of the Federal Coal Leasing Act amendments does not have to produce coal in commercial quantities until 10 years after the date of the first lease readjustment occurring for the pre-Federal Coal Leasing Act amendment leases.

In other words, new leases which are designated by the lessee as part of the logical mining unit which contains leases issued prior to enactment of the amendments do not have to meet the diligent development requirement until the old leases do. Also the Department's proposal provides that all logical mining units would be required to produce coal in commercial quantities prior to the end of 10 years from the most recent effective date of any new Federal lease.

This means that diligence on a lease issued this year could be postponed past 1992 if a subsequent lease were incorporated into the LMU.

If all of this sounds very confusing, I found the explanation by the Department confusing as well and I am open to suggestions as to different ways to read that.

In view of these generous concessions to the coal industry what is left of the diligent development requirements? For one thing there is section 2(a)(2)(a), which prohibits any lessee who has held a coal lease in excess of 10 years from obtaining leases on any Federal minerals.

The Department noted the existence of this important enforcement provision in the supplementary information which accompanied the proposed diligent development rules, perhaps to soften the impression one is left with after reviewing the effect of the rules relaxation. It should be noted that energy companies, natural gas pipeline companies, and smaller oil and gas companies together currently own 31 percent of all outstanding Federal coal leases. And the major oil companies in particular have moved aggressively in the Powder River Basin and elsewhere over the past 15 years to establish a strong presence in the western coal industry.

The existing provision can be viewed as an effective means of preventing the major energy companies from stifling competition for Federal coal reserves by acquiring large reserve holdings and holding them off the market, thus preventing other entrants from developing those resources.

In other words, energy companies which hold Federal leases which are not producing may be induced by these restrictions to relinquish them to other companies which may have the capabilities to develop those reserves in a timely manner.

Though the argument against section 2(a)(2)(a) is couched in terms of the peculiar harshness of prohibiting a delinquent lessee from obtaining any Federal mineral leases, that situation could have been addressed by a proposal to simply insert the word "coal" between "Federal" and "lease" wherever they appear together in the section.

But proponents of the bill have instead recommended a complete elimination of the provision, thereby revealing their intention of ridding the Federal Coal Leasing Act amendments of any meaningful enforcement provision. We believe that it should remain unchanged.

Despite the fact that the 40-year mine-out requirement has been eroded by the Department's proposed rule changes, S. 2704 would abolish the requirement entirely. The 40-year mine-out provision serves several useful purposes. It is an incentive to continuously operate on a Federal lease. It assures a return from royalties both to Federal and State treasuries. It permits State and local governments the opportunity to plan for the financing of infrastructural requirements to accommodate the needs of increased populations brought to communities of the West by coal development.

It assures a determinable timeframe for environmental disturbance and reclamation and it facilitates planning for the agricultural operator who may have a long-range management goal for the surface above, adjacent to or nearby Federal coal tracts. We feel

that the arguments brought forth in defense of the elimination of the requirement are spurious ones.

Though coal is the only Federal mineral to which a mine-out provision applies, other Federal minerals have development restrictions and incentives which are peculiar to them. For example, diligence must be shown on competitive oil leases within 5 years.

Also development worth coal deposits for which a lease is issued are designated by the BLM prior to lease issuance. Though multiple seams often exist on Western coal lands, Federal coal leases stipulate which seams are being leased for development. Finally, it is rare mining equipment which has a usable lifespan of over 40 years.

Deletion of language in section 7(c) which requires the preparation of a mine plan which within 3 years would be another unfortunate step backward for the diligent development concept. The present requirement is an obvious spur to development and obligates the lessee to take steps toward complying with the diligent development and continued operation mandate.

Also the information supplied in the mine plans assists the Department in determining the extent of reserves for purposes of calculating the amount of advanced royalties and payments in lieu of continuous operation.

Now, we have some questions with respect to the proposal to amend section 7(b). It is evident that the proposal not only provides for payments in lieu of continued operation at a rate of 1 percent of recoverable lease reserves, but also substitutes that rate for compliance with the diligent development requirement.

The subcommittee should fully explore what effect the proposed change would have on the incentive to produce coal if a payment at that rate were allowed in lieu of production. It is not a production incentive to pay less than would have been payed if the lease were being mined and royalties paid for the coal produced. The subcommittee should get some idea of the costs involved to the lessee and lessor under this proposal and should examine how the proposed payment formula compares to the costs to the lessee to make investments necessary to bring the lease into production on time to meet diligence.

The overall effect of this proposal is to double the time coal leases may be held out of production, from 10 to 20 years.

Another significant change in section, proposed in section 7(b) would transfer the burden of proof from the operator to show that he cannot meet the conditions of diligent development to the Department to deny the lessee's request. The Department would be placed in the odd position of a lessor who has the burden of proof to show why the lessee should comply with the original terms of their agreement.

As for the addition of a provision to exempt coking coal from the diligent development requirements, the language permits the lessee to receive an exemption from the Department simply by making a showing that the coal will be dedicated to steelmaking.

Such deposits are then subject to the diligence requirements when the lessee decides to sell it for other than metallurgical purposes. It seems then that a lessee can upon obtaining a lease for metallurgical grade coal, simply declare that he intends to use it

for steelmaking and hold it for an indefinite period of time until he decides to do something else with it.

The subcommittee should determine how much coal this provision would affect and what the extent and prospects are for developing nonsteel markets for such coal before acting on the proposal. A significant proportion of Western coal leases are held by steel companies, I believe it is about 8 percent, and the subcommittee should evaluate that factor in making a determination on this proposal.

In conclusion, we believe that the adoption of these proposals when combined with the Interior Department's new rules which administratively relax certain regulations affecting the diligent development requirements and to their plans to lease vast tonnages of Federal coal would for all practical purposes render any remaining diligence provisions of the Mineral Leasing Act meaningless.

In view of the complex uncertainties involving the administration's revision of the Federal coal management program, we urge you to reject these proposals at this time, because they only serve to add more uncertainty to the Government's coal leasing policies.

Thank you very much.

[The prepared statement of Mr. Alberswerth follows:]

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STATEMENT OF

DAVID ALBERSWERTH

ON BEHALF OF

THE WESTERN ORGANIZATION OF RESOURCE COUNCILS

BEFORE THE

SENATE SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES

REGARDING

S. 2704

AUGUST 3, 1982

Mr. Chairman, members of the Subcommittee on Energy and Mineral Resources, the Western Organization of Resource Councils appreciates the opportunity to present our objections to the provisions of S. 2704. The Western Organization of Resource Councils consists of four Western public interest organizations: the Dakota Resource Council of North Dakota, the Northern Plains Resource Council of Montana, the Western Colorado Congress of Colorado, and the Powder River Basin Resource Council of Wyoming. Our membership is primarily composed of family farmers and ranchers who reside in rural communities which are being affected by coal-based industrialization, and who are concerned about the impact of these developments on farming, ranching, and the future of their communities. We have approximately 2500 farm and ranch families in our organization.

Before addressing the specific provisions of S. 2704, it is important to note that the bill has been proposed at a time of confusion and uncertainty regarding the direction of the Federal Coal Management Program under the Interior Department. New rules changes have been proposed by the Department which administratively weaken certain diligent development requirements. These changes were published in draft form last December, with final promulgation due shortly. Until the consequences of these rules changes are understood and evaluated by the Congress, the coal industry, and the public, action on any legislative proposals which amend the Federal Coal Leasing Act Amendments is untimely. It is also noteworthy that none of the proposals contained in the bill effect any immediate problems of the coal industry. Instead, the proposed legislation has apparently been designed to address some of the anticipated future consequences of the present Administrations's coal leasing policies. Until those policies are fully developed and implemented, and their consequences become apparent, any modification of the diligent development requirements

in the manner presented here is untimely and only serves to add to the confusion and regulatory uncertainty which presently characterizes the coal leasing program.

S. 2704 should be considered by the Subcommittee in the context of (1) the legacy of past coal leasing practices, (2) current and future market conditions affecting the Western coal industry, and (3) the Interior Department's proposals to change the emphasis of the Federal Coal Management Program and weaken the diligent development requirements via rules changes.

The diligent development requirements embodied in the Federal Coal Leasing Act Amendments (FCLAA) of 1976 were a logical consequence of the discovery by Congress in the mid-70s that previous federal coal leasing policies had amounted to a giveaway of valuable coal deposits into private hands, largely for speculative purposes. The realization that over 16 billion tons of federal coal reserves had been leased with virtually no commitment on the part of lessees to develop those reserves, and no legal requirement that they do so, resulted in the present diligent development provisions of the Mineral Leasing Act being enacted by Congress over a Presidential veto. Congress correctly perceived that the Interior Department, with both fiduciary responsibilities to the treasury and as steward of the public's energy resources, was obliged to manage the public's coal in a prudent, business-like manner. The rationale for the diligent development concept was aptly described in the Department's 1979 environmental statement on the Federal Coal Management Program:

> "Diligent development and continuous operation regulations discourage companies from failing to develop Federal coal leases, minimize inefficiency and wasted effort in planning for coal leasing and production, and help ensure that the government will receive fair market value for leases."[1]

In other words, federal coal leases should only go to those who plan to develop the resource in a timely manner. Another important purpose of the diligent development provisions is to provide some degree of certainty to both federal and state governments regarding when royalties from production will be forthcoming over time. Also, some certainty regarding the timing and duration of coal mining activities benefits state and local government planning needs. These governmental entities can count on development of federal coal tracts beginning within ten years of lease issuance, with completion of mining activities within forty years. This assists state and local governments in planning for the development and financing of social infrastructural requirements which are usually needed in the small rural communities of the West which face the prospect of rapid population growth and jarring social change. The requirements also help agricultural operators who own or lease the surface over or adjacent to leased federal reserves to make planning decisions for their operations: for example, whether or not to expand or invest in irrigation equipment, or make other capital improvements. Finally, the diligent development and continuous operation requirements assure that the environmental disturbance and reclamation of strip mined lands will take place during a determinable period of time.

According to the Office of Technology Assessment (OTA), in its report entitled An Assessment of Development and Production Potential of Federal Coal Leases (December, 1981), there are currently over 16 billion tons of federal coal under lease. Although 70% of these leases might meet the Interior Department's existing diligent development regulations*, 30% of these leases, containing 3.4 billion tons of coal, might not. From our perspective the situation in the Powder River Basin of Wyoming and Montana is especially important to these

* 2½% of LMU reserves produced by 1986, with the opportunity for a 5 year extension.

considerations. Not only is this region home for many of our members, but the Powder River Basin contains over one-half of the recoverable federal reserves under lease (9.2 billion tons) accounts for over one-half of the coal produced from mines containing federal leases, and includes the largest amount of undeveloped leased reserves in the U.S. According to OTA, of the 9 billion tons of federal coal under lease in the Powder River Basin, approximately 3.3 billion tons are so far from development that no mining plans have been submitted for them. More importantly, uncertainties exist regarding whether or not 1.2 billion tons will meet the present diligent development rules by 1991, and 1.5 billion tons are considered "unlikely" to meet those rules.[2] In fact, the reality of this enormous over-supply of federal coal leases in the Powder River Basin, and the likelihood that a large proportion of these reserves will not meet current diligence rules, is one of the primary rationales used by the Department to justify relaxation of the current diligence requirement.

Future demand for Powder River Basin coal, and indeed most western coal, is dependent upon electric load growth rates. These have been dropping since 1973. In 1980 the National Electric Reliability Council (NERC) projected an annual load growth rate of 4.1 percent through 1990. This projection was used by OTA as a basis for its projection that 1990 demand for Powder River Basin coal would be in the range of 200 to 225 million tons.[3] Coal contained in existing federal leases can easily accomodate this demand without further leasing. Because the latest NERC projection places annual load growth at 3.6 percent, OTA has lowered its demand estimate for the Powder River Basin to a range of 180 million tons per year to 225 million tons per year.[4] Verifying this downward trend has been the leveling off of the annual increase in coal production in Wyoming. According to the Wyoming Geological Survey,

last year's growth rate in coal production in Wyoming was 9 percent, compared to an average of 28 percent per year since 1970. The Survey predicts growth at this level for the foreseeable future.5

In short, what we have is a situation where there is such a great over-supply of available federal coal reserves, much more than needed to meet any reasonable expectation of future demand, that the Administration feels compelled to relax the requirement that these leases be developed during this decade. One would think that, given this situation, the Department would moderate its plans to lease more coal in the region. On the contrary. Despite the over-supply of federal coal leases, overcapacity at existing mines (mines operated at less than 60% of capacity last year), and the continuing decline of electric load growth rates, the Department plans to lease over 5 billion tons of coal throughout the West during the next two years. In April the Department held the largest coal sale ever in the Powder River Basin, 1.5 billion tons. As to policy, the Department has announced that in the future, federal coal deposits will be leased on the basis of meeting the coal industry's desires to control large inventories of coal reserves, rather than the present policy of leasing coal to meet the nation's needs for coal production. <u>If the Department is successful in carrying out its changes in policy, the diligent development provisions of the FCLAA will be the only remaining check on the industry's ability to acquire vast reserves of federal coal for speculative purposes</u>. In the absence of strong diligent development provisions, the "demand for reserves" for which the Department now proposes to lease will be a speculative demand.

To sum up the circumstances of the federal coal leasing program as it stands

today:

(1) There are over 16 billion tons of federal coal under lease.

(2) Thirty percent (3.4 billion tons) of this coal is unlikely to meet the Department's diligent development rules which apply to these leases.

(3) The Interior Department has proposed to relax the diligent development rules affecting leases issued prior to enactment of the FCLAA in order to accomodate existing lessees who have no market for the reserves they hold, and to prevent large inventories of coal being turned back to the government.

(4) Despite the great over-supply of existing coal leases, particularly in the Powder River Basin, and slack market conditions, the Department has announced its intention to dump vast inventories of additional coal on the market in new leases to be issued during the next two years. Additionally, the Department has announced a new policy of leasing coal to meet the industry's needs to control large inventories of coal reserves, rather than leasing coal to meet the nation's needs for energy production.

(5) The coal industry has now proposed statutory changes in the Federal Coal Leasing Act Amendments which essentially gut the diligent development requirements, the only effective check on leasing coal for unbridled speculation.

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Before going on to the specific provisions of S. 2704, it is important to consider some of the Department's proposed changes in the diligent development regulations, and compare them to existing provisions of the rules. A few pertinent comparisons follow:

--Under present rules, all leases issued prior to enactment of the FCLAA must produce 2½ percent of reserves by 1986, with an opportunity for an extension to 1991.

The Department's new proposal would require production of 1% of "LMU coal reserves" within 10 years of the first lease readjustment. Lease readjustments normally take place twenty years after lease issuance. Therefore, for example, a logical mining unit made up of leases issued in 1970 must produce 1% of its reserves by 2000, rather than 1986.

--Existing regulations provide that all leases upon issuance are automatically considered to be a "logical mining unit" or "LMU". A mine plan must be submitted within three years of lease issuance, and the forty year mine-out clock starts ticking upon approval of the mine plan.

The Department proposes that the forty year mine-out provision commences only after a LMU is formed upon request of the lessee, and after the date of first production. No time limit for LMU formation after lease issuance is provided. Also, if the mine plan is for an individual lease, the forty year mine-out requirement will no longer be required. Therefore, a lessee can evade the forty year mine-out provision by simply not declaring the formation of a LMU.

--Under existing requirements, any lease issued after August 4, 1976 (the date of enactment of FCLAA) must produce 1% of its reserves within 10 years of issuance.

Under the Department's new proposal, any lease issued after August 4, 1976 and included in a LMU which includes leases issued prior to enactment of the FCLAA does not have to produce coal in commercial quantities until ten years after the date of the first lease readjustment occuring for the pre-FCLAA leases. In other words, new leases which are designated by the lessee as part of a LMU which contains leases issued prior to enactment of the FCLAA do not have to meet the diligent development requirement until the old leases do. Also, the Department's proposal provides that all LMUs would be required to produce coal in commercial quantities prior to the end of ten years from the most recent effective date of any new Federal lease. This means that diligence on a lease issued this year could be postponed past 1992 if a subsequent lease were incorporated into the LMU.*

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*This interpretation is based upon the following explanation of the rule provided by the Department in its supplementary information accompanying the proposed rule change: "All LMU's would be required to produce coal in commercial quantities prior to the end of ten years from the most recent effective date of any Federal lease or leases included in the LMU issued on or after August 4, 1976, or of the first lease readjustment after August 4, 1976, for those Federal leases included in the LMU issued prior to August 4, 1976. However, if the LMU contains a Federal lease issued prior to August 4, 1976, that has not been readjusted since August 4, 1976, coal from that LMU must be produced in commercial quantities prior to the end of ten years after the date of LMU approval." (46 Fed. Reg. 62,230 (1981))

In view of these generous concessions to the coal industry proposed by the Department, what is left of the diligent development requirements? For one thing, there is Section 2(a)(2)(A) which prohibits any lessee who has held a coal lease in excess of ten years from obtaining leases on any federal minerals. The Department noted the existence of this important enforcement provision in the supplementary information which accompanied the proposed diligent development rules, perhaps to soften the impression one is left with after reviewing the effect of the rules' relaxation. It should be noted that energy companies, natural gas pipeline companies, and smaller oil and gas companies together currently own 31% of all outstanding Federal coal leases, and the major oil companies in particular have moved aggressively in the Powder River Basin and elsewhere over the past 15 years to establish a strong presence in the Western coal industry. The existing provision can be viewed as an effective means of preventing the major energy companies from stifling competition for federal coal reserves by acquiring large reserve holdings and holding them off the market, thus preventing other entrants from developing those resources. In other words, energy companies which hold federal leases which are not producing may be induced by the restrictions of Section 2(a)(2)(A) to relinquish them to other companies which may have the capabilities to develop those reserves in a timely manner.

Though the argument against Section 2(a)(2)(A) is couched in terms of the peculiar harshness of prohibiting a delinquent lessee from obtaining any federal mineral leases, that situation could have been addressed by a proposal to simply insert the word "coal" between "federal" and "lease" wherever they appear together in the section. But proponents of the bill have instead recommended a complete elimination of the provision, thereby revealing their true intention of ridding the FCLAA of any meaningful enforce-

ment provision. The provision should remain unchanged.

Despite the fact that the forty-year mine out requirement has been eroded by the Department's proposed rules changes, S. 2704 would abolish the requirement entirely. As discussed earlier, the forty-year mine out provision serves several useful purposes: It is an incentive to continuously operate on a federal lease; it assures a return from royalties to both federal and state treasuries; it permits state and local governments the opportunity to plan for the financing of infrastructural requirements to accomodate the needs of increased populations brought to communities of the West by coal development; it assures a determinable timeframe for environmental disturbance and reclamation; and it facilitates planning for the agricultural operator who may have a long-range management goal for the surface above, adjacent to, or nearby federal coal tracts. We feel that the arguments brought forth in defense of the elimination of the requirement are spurious ones. Though coal is the only federal mineral to which a mine-out provision applies, other federal minerals have development restrictions and incentives which are peculiar to them. For example, diligence must be shown on competitive oil leases within 5 years. Also, development-worthy coal deposits for which a lease is issued are designated by the BLM prior to lease issuance. Though multiple seams often exist on western coal lands, federal coal leases stipulate which seams are being leased for development. Finally, it is rare mining equipment which has a useable lifespan of over forty years.

Deletion of language in Section 7(c) which requires the preparation of a mine plan within three years would be another unfortunate step backwards for the diligent development concept. The present requirement is an obvious spur to development, and obligates the lessee to take steps toward complying with the diligent development and continued operation mandate. Also, the information

supplied in the mine plans assists the Department in determing the extent of reserves for purposes of calculating the amount of advanced royalties and payments in lieu of continuous operation.

Some questions arise with respect to the proposal to amend Section 7(b) as proposed. It is evident that the proposal not only provides for payments in lieu of continued operation at a rate of one percent of recoverable lease reserves, but also substitutes that rate for compliance with the diligent development requirement. The Subcommittee should fully explore what effect the proposed change would have on the incentive to produce coal if a payment at the rate proposed were allowed in lieu of production. It is not a production incentive to pay less than would have been payed if the lease were being mined and royalties paid for the coal produced. The Subcommittee should get some idea of the costs involved to the lessee and lessor under this proposal, and should examine how the proposed payment formula compares to the costs to the lessee to make investments necessary to bring the lease into production on time to meet diligence. The overall effect of this proposal is to double the time coal leases may be held out of production -- from 10 to 20 years.

Another significant change in Section 7(b) would transfer the burden of proof from the operator to show that he cannot meet the conditions of diligent development or continuous operation and should have those conditions suspended, to the Department to deny the lessee's request. The Department would be placed in the odd position of a lessor who has the burden of proof to show why the lessee should comply with the original terms of their agreement.

As for as the addition of a provision to exempt "coking coal" from the diligent development requirements, the language permits the lessee to receive an exemption from the Department simply by making a "showing" that tne coal will be dedicated to steel making. Such deposits are then subject to the diligence requirements when the lessee decides to sell it for other than metallurgical purposes. It seems, then, that a lessee can, upon obtaining a lease for metallurgical grade coal, simply declare that he intends to use it for steel making and hold it for an indefinite period of time until he decides to do something else with it. For example, he might sell it at a profit to another party (that is, hold it for speculative purposes), or eventually find a steam coal contract. The Subcommittee should determine how much coal this provision would effect, and what the extent and prospects are for developing non-steel markets for such coal, before acting on the proposal. A significant proportion of western coal leases are held by steel companies, and the Subcommittee should evaluate that factor in making a determination on this proposal.

In conclusion, we believe that the adoption of these proposals, when combined with the Interior Department's plans to administratively relax certain regulations affecting the diligent development requirements and to lease vast tonnages of coal, would for all practical purposes render any remaining diligence provisions of the Mineral Leasing Act meaningless. To sum up the cumulative result of S. 2704 and some of the Department's proposed rules changes:

(1) There would be no forty-year mine out requirement.

(2) There would be no three year mine plan requirement.

(3) Payments in lieu of production in commercial quantities could be substituted for actual production in commercial quantities. The rate of payment in lieu of production in commercial quantities might not be an incentive to develop a federal lease. Such payments might not even offset the rate of appreciation of a federal lease on the assignment market. A federal leaseholder could hold a lease for up to 20 years without producing any coal.

(4) Lessees who are delinquent in meeting their diligent development obligations will be eligible to obtain more federal leases.

(5) An important sector of the coal industry is exempt from the diligent development requirements altogether.

(6) Another sector of the coal industry is provided with an across the board 5 year extension of the diligent development period.

(7) Many lessees who hold old non-producing federal leases will be able to keep them well past the current 1986 deadline for diligent development, some until the end of the century without producing any coal.

(8) New lessees may evade the diligent development requirement on their new lease by obtaining additional leases later and indefinitely postponing declaration of the formation of a "logical mining unit."

Given the present Administration's zeal in turning over large coal inventories to the industry on the basis of the industry's desire to amass huge Western reserve holdings, these administrative and legislative packages combined will result in a virtual return to the days when federal coal deposits were obtained cheaply, and speculators happily traded leases to each other, while the public lost control of its own energy resources and received little or no return for them. In view of the complex uncertainties involving the Administration's revision of the Federal Coal Management Program, we urge you to reject these proposals which will only serve to add more uncertaintity to the government's coal leasing policies.

FOOTNOTES

1. Final Environmental Statement, Federal Coal Management Program, United States Department of the Interior, April, 1979, p. 5-184.

2. An Assessment of Development and Production Potential of Federal Coal Leases, Congress of the United States, Office of Technology Assessment, December, 1981, p. 29 (Executive Summary).

3. Ibid., p. 28.

4. Statement of Audrey Buyrn, Program Manager, Materials Program, Office of Technology Assessment, Before the Subcommittee on Energy and the Environment, Committee on Interior and Insular Affairs, United States House of Representatives, May 11, 1982 (oral statement)

5. Caspar Star-Tribune, Caspar, Wyoming, April 4, 1982.

Senator MURKOWSKI. Thank you very much, Mr. Alberswerth. I have some questions that I am just going to arbitrarily direct to whoever may feel more comfortable or knowledgeable about the specifics and it would be quite appropriate to go ahead and respond.

As I indicated in my opening statement I was concerned about the speculative aspects as they are addressed in the bill and evidently collectively you gentlemen do not feel that we have taken enough safeguards in the draft legislation so that we have eliminated the speculative aspects. I wonder if you have any concrete suggestions on how you feel we might address this area to tighten it up.

We have heard the testimony from the industry groups with regard to speculation. Have you decided you are concerned with it?

Mr. ALBERSWERTH. One remark that I would like to make is that on the issue of payments in lieu of diligent development, we don't necessarily object to that idea, but we just feel that it is important that the subcommittee and the Congress have a firm idea in mind of what the affect of such payments would be as an incentive on production and we believe that the Government should not get any less money on those leases than they would if there were actual production on them. And I think that is something that we hope will be kept firmly in mind by this subcommittee when it deals with this proposal.

Mr. GAWELL. I am not convinced, first of all, that the industry has made a showing of fact to substantiate the provisions that it desires. I would like to state, I would like to respond to your question in writing. To give you an example, the American Mining Congress represented, stated that one of the things you should do for old leases is make sure that the payment, the 10-year payment period continues only after the initial 10-year diligence period.

I think that should be applied to both leases if such a provision is passed and I agree with David that it must be a national incentive. The level has to be set so it is a national incentive. If you look at

the testimony if they note the real value of coal between 1975 and 1980 it went up in real dollar terms by 6 percent.

So, in other words, the value you hold in the ground went up by 6 percent over that inflation period. The payment you make is actually very small. They do not give the money away. It is not lost when they pay an advance royalty. It is later taken off what they owe to the Government. They are paying on 1 percent of the coal. They are paying 12 percent and that you have to consider. That is what they are really losing, the cost of money.

The cost of money OMB says that the cost of money is 7 percent. When you take 1 percent of the coal 12 percent of that value and 7 percent of that value, you have a very small amount of money that they are actually paying.

Senator MURKOWSKI. We would appreciate your submitting written comments for the record with regard to any suggested changes with regard to the speculative aspects or for that matter any other, others that might come to your attention.

How is it in the public interest for leaseholders to produce their interest by August of 1986 or be barred from bidding on other leases? Would this not affect or require the sale of any leases, if any leases would come up at that particular time? Because I assume the company would find it more advisable to crop their leases and sell them than to go ahead and develop them, because they may want to bid on other mineral leases.

What is the advantage to the consumer if you restrict the amount of coal that can be produced? The cost will go up and companies will have to pass that on to the consumer. We are in a substantial glut.

Mr. GAWELL. First of all to assume that leasing further on the glut helps the consumers, I do not think is very credible. If we were leasing at the point where we were restricting the ability to produce coal, you may be right there that we affect the consumer cost. We are deep in a glut at the moment and into the foreseeable future.

I cannot see how it will affect the consumer rate. There has been confusion about the point of other Federal leases. The simple fact of the matter is the corporate representatives in the previous panel say they intend to sue the Federal Government if they attempt to take a lease away from them. The reason the Federal Government put this in was because of the widespread speculation in the 1960's. It was by a vote of two-thirds of the House and two-thirds of the Senate Members. It was a way out of the problem we got ourselves into.

Mr. ALBERSWERTH. May I respond to that question as well, sir?

Senator WARNER [presiding]. Yes, sir. Before you respond, we have an unusual situation. The Senate has five rollcall votes back to back. And I am going to turn the chair over to the Senator from Alaska and I will vote and then come back.

Senator MURKOWSKI [presiding]. Thank you, Senator. Evidently these votes will take about an hour. Between Senator Warner and I we will conclude the hearing and I thank you for your patience.

Are we not kind of putting ourselves in the position where we could force the production of coal by leaving the statute where it is, even though there may not be any market for it at any given time?

Mr. ALBERSWERTH. Before I address that, could I address your previous question?

Senator MURKOWSKI. Sure.

Mr. ALBERSWERTH. I believe the idea of that, the 1986 date, was when it was first adopted by the Congress and in the Department's previous rules was indeed to force holders of Federal leases which were not producing by 1986 to give them up. And the idea was that they would then go presumably to others who did have the wherewithal to produce on those leases.

And I think that is a legitimate attitude for the Government to have in regards to the disposition of its coal.

Mr. GAWELL. Basically what I think it is, we are proceeding as the Government in a businesslike manner in dealing with the public's resources. And we are saying we are responding to a situation that asks for speculation. Now, the question I think you are hinging on is what is going to happen down the line. Are we going to get into a position where we are going to be having a shortage of coal.

First of all, I personally doubt that will happen and, second, I would like to note that even during the moratorium they were issuing leases; they were extending leases to meet production needs, even under the strictest possible provisions, let alone under the 1976 Federal Coal Leasing Act Amendments.

There is wide latitude in the current regulations. We are going to be allowing, if the regulations stand, the pre-1976 leases to not produce for another 20 years. At best perhaps we are looking at a situation if the Federal Government issued no new leases we might be in a supply problem at the turn of the century and I doubt that that will happen. I think we will continue with new leases.

The question is whether or not we want to glut the market. The question is whether or not we want to turn control over to what will be produced, when it will be produced to the coal companies, which in fact, if we lease or preserve, we are not going to get much money for our coal, the Treasury will lose on that deal, and whether or not we want the tremendous realm of uncertainty for the people who live in the area where coal production is taking place.

Senator MURKOWSKI. You made reference to Secretary Watt as the steward of our national interest lands. I gather that you feel that he seems to be giving away our coal as quickly as he can. What do you think is the motive there?

Mr. GAWELL. I don't feel it is my place to speculate on the Secretary's motives. I think in his case, I think it is an honest belief in a particular outlook toward the Federal lands that takes us back to the 1970's. I think that he feels personally, as he has stated, that what has happened in the 1970's in terms of change of the Federal lands is that it now is viewed as a public resource, held by the Government for the public in trust, and it is the wrong principle on which to operate.

Specifically with respect to coal leasing, he believes that the Government should simply lease everything that industry asks for, which is absolutely counter to the Coal Leasing Act amendments and the intent of Congress at that time. He has proceeded with quite an enormous coal leasing plan.

He announced their second call for an issue, statements of interest on the 1984 sales in the Powder River Basin, which they say is going to be even larger than the last sale they just held. As you probably know we do have litigation on that sale, which is in district court in Montana, and one of our points there is that the Federal Government did not receive fair market value for its coal.

Mr. ALBERSWERTH. Senator, I think one of the issues that this subcommittee should keep in mind in regard to the whole question of fair market value is that what we have seen happen in the Powder River sale, for example, is that because of the fact that there is a glut of western coal on the market now, the bonus bids that were received on that sale were quite low, about 3½ cents a ton.

The Interior Department has pointed out that it is unfair to use that amount of money as the definition of fair market value when in fact the Government will get royalties at 12½ percent on the coal that is eventually produced. That assumes that that coal will be produced and in production under the terms of diligent development and continuous operation after 10 years. So that if we are to get any kind of fair market value, we need to assure that the coal that is leased will actually be in production.

Senator MURKOWSKI. I think it is fair to point out too that the Powder River lease sales were under the previous administration as far as the timing and the planning that was done and so forth. I think it is also appropriate to point out that there are some 50 billion acres of coal land in the western area and I think that this proposal has put up about 1½ billion at the present time.

So it is a question of what is reasonable and what is unreasonable as far as the policy of the Secretary of the Interior to put up leases as quickly as they can.

Tell me what is the concern primarily of the 40-year mine-out requirement, particularly it applies to coking coal, where they are in there and they are established and suddenly their 40 years are up. And there is really no procedure as to what happens after that or how the Government treats the termination of at least the improvements that are made. Why should not the parties have the option to mine out the reserves, assuming the reserves are adequate to tail in the extended period beyond 4 years?

Mr. ALBERSWERTH. I felt that Mr. Lloyd's presentation was actually quite convincing this morning. We have not specifically objected to that the proposal to exempt coking coal from the diligence requirements. What we have a problem with is how you determine what coking coal is and what kind of assurance do you have that indeed the Federal coking coal reserves are dedicated to coking coal.

In other words, we are worried that coking coal might be used in the steam coal market. And if there were sufficient assurances in the proposal to make sure that the coal would be dedicated to steelmaking, I think we could live with that.

As far as the other 4-year mine-out provision applying to steam coal, we have laid it out in our testimony, we feel that there are a number of purposes that are served by that provision.

Mr. GAWELL. The problem is, if I can just interrupt.

Senator MURKOWSKI. I am going to have to recess, because I have to get over there. And I do appreciate your testimony. I have no further questions. I am going to excuse you two witnesses, Mr. Gawell and Mr. Alberswerth, and take a 5-minute recess. I believe Senator Warner will be back at that time.

I want to thank you for your testimony and for responding to the questions that we had and I would ask that you would go ahead and submit during the 10-day period anything you would care to for the record.

With that, we will take a 5-minute recess.

Mr. ALBERSWERTH. Thank you very much.

Mr. GAWELL. Thank you very much.

[Whereupon, there was a recess.]

Senator WARNER [presiding]. Our next witness will be H. deForest Ralph, vice president, Coastal States Energy Co., Houston.

We apologize, Mr. Ralph, for the possible inconvenience to you, but you are familiar with our procedures up here. You are a veteran before this committee.

STATEMENT OF H. deFOREST RALPH, JR., VICE PRESIDENT, ECONOMICS AND PLANNING, COASTAL STATES ENERGY CO., HOUSTON, TEX.

Mr. RALPH. Thank you, Mr. Chairman. I appreciate that and it is certainly a pleasure for me to be here again. My name is Henry deForest Ralph, Jr. I apologize for the long name, but you will have to talk to my mother about that. I am the vice president of economics and planning for Coastal States Energy Co. of Houston. We are part of the Coastal Corp., which is a large energy company engaged in many different activities.

Senator, I have a prepared statement, which I will not read, but I would like to kind of summarize a little bit. I would like to have it entered in the record.

Senator WARNER. We will put it in the record in its entirety.

Mr. RALPH. Thank you. I would like to say at the beginning that the Coastal States as a company is quite supportive of Senator Murkowski's bill here in the Senate and also its companion bill that was entered into the House by Congressman Kogovsek.

The provisions, we feel, of the bill provide some flexibility the need for which would come to light due to trying to implement the law since 1976. We feel that the flexibility will benefit all people in the United States in different aspects. I would just like to mention a little bit some of the aspects of what a coal company goes through and how the leasing amendments, particularly the ones that are being considered, affect their decisions in what they are trying to do.

A coal company is trying to develop coal to supply the markets, generally they are motivated by several different elements, none of the least of which is profit; But also my experience almost 30 years in the energy companies is almost all are motivated by a feeling of national service as well. And they conduct their activities on these as well as on economic grounds.

So many companies, like ours, responded to the perceived need for coal as an answer to America's energy needs during the 1970

period. We acquired some leases out in southern Utah from a company that had held them since the forties when they began to develop the mine and we expanded those and we got up to the, developed the mine and developed our markets and we had to deal with the Federal Government both in the USGS but also with the Forest Service, which is our surface landlord owner.

Then we did acquire some additional leases from another energy company about 150 miles away in another national forest and this other energy company had acquired the leases from the man who first got them from the Government in 1960. I don't want to talk about speculators, but look at it a slightly different way, this one man you might call a visionary.

He went out and found out where the coal was and went to find out how to lease it and attempted to develop it, hoping to finance his position and develop coal. He died and the leases from his estate were transferred to an energy company in Colorado.

They also found out that the requirements for opening the mine up there exceeded their plans and capabilities and with the passing of the Leasing Act amendments, they had two choices. They knew they could not ever develop it so they could either let them lapse and lose their money or try to find somebody else who could develop them. And we were able to make that arrangement with them.

So what we had to do was to look at our development plan when we went to acquire the leases and look at the constraints and all of the factors affecting our decisions. You will notice in my heading here I say summary of leasing and mine development decision. It is supposed to say "steps" but it says "stops and actions." In retrospect that may be as much a Freudian slip as a secretarial mistake. Because many of these decision steps do have stops in them and companies very well can come to a point and say I can go no further. A prudent step for me is to get out one way or the other.

And some of these are brought on by the Federal Government's regulations both here and in other areas.

Senator WARNER. Excuse me, I have to go to the floor right away. So wait for Senator Murkowski to come back.

Senator MURKOWSKI [presiding]. We will reconvene. I believe that Mr. Ralph is before us, who is in the middle of his testimony and we have Michael Kokeda who will be coming up next. I might advise you that the likelihood of finishing this with some type of a reasonable order is rather remote.

As a consequence, I would appreciate a summary, if you would care to, because I probably have got about 10 minutes before the next vote and then it is going to be a series of that and then we are going to conclude by noon. So regardless of that, I would appreciate you doing the best you can, Mr. Ralph.

Mr. RALPH. Thank you, Senator. I was just discussing some of the factors that a coal company considers and how some of these leasing regulations affect them and how they can affect the national interest as well as that of a particular coal company.

When you are looking to go into the coal business, let us say, or finding a place where you can do this, you look at the general geological areas and the geological information that is available to you and try to find coals that will have the characteristics that you think there will be a broad market for and you try to get whatever

information you can there and you look at what the leasing situation is likely to be and what the regulations are likely to be, and having gone through those steps, you may at that point in one fashion or another acquire some leases either from somebody who already has them and for one reason or another could not develop them.

As I mentioned earlier, we actually bought leases from a company that had Federal leases but felt they could not develop the leases because of the high costs involved and they had other areas where they wanted to put their money. They had uranium mining at a time when uranium was supposed to be a good deal.

So in looking at those leases there in Utah we calculated fairly carefully the problems we would have in developing those leases to meet the regulations. These were leases that were pre-FCLAA but we had the diligence requirement to have our production up by 1986. So this became a critical factor.

One of the things we had to look at was do we first acquire a market for this coal or do we try to develop the mine without having a firm market. So we had had good experience in our other mines in southern Utah, developing the mine and finding the market and being a low-cost producer we were quite competitive. And so that was the approach we took and found it was a very high-risk one.

Because we were putting out our money with no contract from a utility or a large customer or an export trade to in effect to take down to the bank our company's credit. It was totally on the line and we did not have project financing per se. We applied to the Office of Surface Mining, and received our permit. There was a great deal of risk involved there. We could have been delayed by 2 or 3 years, had we not been able to convince a lot of the agencies, the Forest Service, the USGS, the Office of Surface Mining, and the Utah Department of Oil, Gas and Minerals to work together toward any merit where we could get our permit in a short period of time.

Had we been delayed, we would not have been able to meet the 3-year requirements of the plan, nor would we have been able to contemplate meeting the 1986 requirement. I have behind me here a rolled-up diagram that is 4 feet wide and 20 feet long. It is the perk chart, a diagram showing the critical steps that we had to go through from 1978 to 1991 to try to meet these requirements, the legal requirements regardless of whether they were economically sound or not. We felt we could, but we knew we were at risk at all times.

So having seen the development of mines and underground mines, which means it comes on very slowly, one of the problems with the underground mines is you have to burrow into the hole into the ground to find a place to even begin to work. You have got to create working spaces, so the production comes up very slowly.

Then you have the problem of trying to match markets. You have to sell at short term very often, because you don't have enough production to satisfy a powerplant. Now, we are out looking for a market for our coal in large quantities, 2 to 3 million tons per year and we have been negotiating quite a bit with a power company, or power authority, there in Utah.

They had planned to, when they were first looking at our mine, they had planned to buy 8 to 10 million tons of Utah coal. As time has gone on they have now talked about getting leases themselves to develop and so we will now lose part of that market.

Lately, they have been concerned over the need for power and they are talking about cutting back possibly from about four units to two units. So the market that we were looking at may not be there when the mine is up to capacity. So then we are faced with the problem of having invested at this point maybe $125 million in these leases for markets to serve the people of southern California who 3 or 4 years ago were in desperate need for electricity and we find that due to conditions beyond our control the market is not there and we have to wait.

To add to the indignity of taking away the leases, when we have made an honest effort to try and provide energy for the country, for the people in the West, on top of the financial losses, if we don't sell the coal we don't make any money and we don't earn any return. And the cost of money is somewhat higher than 7 percent to our company, I will tell you that. The interest rate is 20 percent even on an after tax basis.

We don't take a casual view toward the cost of money we have put out. On top of all these and the time the FCLAA regulations came out and I guess six or eight other regulations, all of which have one way or the other tended to reduce the effectiveness from mining coal. Something as simple as the Staggers exemption for changing the railroad regulations has altered the price of coal delivered to the customer, such that the competitive advantage that we thought we would have is gone, at least has been diminished considerably.

I am not saying there should be a great deregulation of the railroads, but it is just one of the Federal actions which this branch of the Federal Government has taken which diminished the value of the leases we had and the ones we are planning. Others are changes in the Clean Air Act. This was low sulfur coal and then all of a sudden they—and we thought everyone was going to want low sulfur coal. It is high BTU coal. It is similar to the Eastern low sulfur coal like you have in Kentucky. It is low ash, wonderful coal.

But all of a sudden they have changed the regulations where everybody has to have a scrubber and so again we lose part of the potential that we felt we were going to have. All of this is going on with these very tight regulations that have been imposed on people who want to mine coal.

To kind of summarize a little bit, the problem that I see and I think the Congress ought to appreciate is that we don't have to mine coal. Our company does not have to do that. We can take our money and go somewhere else and try to make money doing something else, whether it is running hotdog stands or what have you. And the FCLAA steps that were put in in 1976, as Congressman Kogovsek as he described as a time of hysteria, it was worse than that I feel. Maybe that is because I work for an energy company and live in Texas and am fair game for whatever.

The whole approach is one of punitiveness. In effect what they are saying is if you have the audacity to try and mine Federal coal, we are going to treat you like a second class citizen; we assume

that you are some kind of a character who is out to do in the American public, even though we assume you are an American.

So the people, they will try to make money, but they are not going to keep putting themselves into the position of being castigated when they are trying to be helpful and do their part within a free enterprise system to solve and address some of the energy problems that we have in this country.

All we are asking for here is just a little more breathing room, a little more relief to where the people can adjust to these things. They are about to change all of the regulations again. We are only 5 years through this 10-year period. How can you commit all of this money and never knowing what the game is going to be. It is sort of like the story of the guy who is going to play cards in the Black Horn Saloon and his friends told him on the street that you don't want to go play cards in that game; that is a crooked game. And he says, yes, but it is the only game in town.

So what are you going to do when they run out of all the money? You are not going to have any more players.

Thank you, Senator.

[The prepared statement of Mr. Ralph follows:]

TESTIMONY BY H. DeFOREST RALPH, JR.
VICE PRESIDENT, ECONOMICS & PLANNING, COASTAL STATES ENERGY COMPANY
BEFORE THE U.S. SENATE ENERGY AND NATURAL RESOURCES COMMITTEE,
SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES - AUGUST 3, 1982

Mr. Chairman, my name is H. deForest Ralph and I am vice president of Economics and Planning for Coastal States Energy Company of Houston. In appearing before you today on behalf of Coastal, I am presenting the views of a company actively mining several federal coal leases in the West, and one that has evaluated numerous others. I will state at the outset that Coastal enthusiastically supports the amendments to the Mineral Lands Leasing Act, as proposed in S.2704. The provisions of this bill provide the coal industry with some much needed flexibility for planning and operating mining activities on federal leases; flexibility that is critical to the long- term, orderly development of this important natural resource.

Summary of Leasing and Mine Development Decision Stops and Actions

In deciding on whether to bid for a federal coal lease, and how much that bid should be, a company must follow a logical decision-making process and examine many important issues: (1) Geology - How much and what kind of coal is there on the lease? (2) Engineering and Construction - What problems might we encounter and what would be the optimum method of mining? How much would mine development and construction cost and how long would it take? How much coal could we produce and at what price? (3) Marketing - Who would be potential customers for this particular coal? How much coal would they need, when would they need it, and for how long? (4) Transportation - How would the coal be moved to the customer and at what cost?

Impacting all of the items I have mentioned is one central, fundamental issue: the extent to which regulatory constraints and requirements will override and contravene decisions and actions which otherwise would be based on normal economic factors. These regulations essentially define how fast we must find and contract with customers, how much coal we must mine and how long we have to mine it. As an example: Under current legislation, within three years of issuance of the lease, we must file a detailed operating and reclamation plan which covers the entire life of the lease. Since development and production must be tailored to the needs of the marketplace, we must first find a customer or customers for the coal in sufficient time to prepare and submit the plan. Unfortunately, before we can sell a customer on our mine proposal, it is necessary to conduct a detailed geologic exploration to determine what we really received in the lease sale. Including the permitting required to drill and explore the lease, this definition of reserves and quality can take several years, particularly if the surface is federally owned, such as in a national forest where the exploration program activities must conform to environmental and public usage consideration which might prevent adequate exploration within the contemplated time frame.

Assuming we have defined our reserves, found a market and filed our initial mine plan on time, we then have until the tenth year of the lease to place it into production of "commercial quantities" under the diligent development requirements of the Federal Coal

Leasing Amendments Act (FCLAA) of 1976. Under some circumstances this time period is adequate; for others it is not. If the customer should be a new coal-fired power plant, as is usually the case, we are dependent upon the power plant design, permitting and construction being accomplished with little or no delay, in order to meet the ten-year deadline. If there are delays and we cannot begin production within the ten years allowed, the lease may be terminated without regard to any progress that we may have made on mine construction and development.

Once again assuming the regulatory deadline is met, we then have the requirement that the coal reserve must be depleted within 40 years of approval of the mine plan; no exceptions. This is a particular hardship in the case of power plants and steel making facilities which have lives longer than 40 years and require dedication of specific coal reserves for the life of the facility.

As pointed out in the above discussion, one of the major problems in the current regulatory environment facing the coal industry is that of inflexibility. This bill, S.2704, addresses this in the area of diligence in lease development. It will ease the burden on federal leaseholders while still maintaining adequate controls to ensure reasonably diligent development of federal coal resources in a manner consistent with the national interest.

Additional Leasing Prohibition

Section 3 of the FCLAA prohibits the issuance of any type of mineral lease--coal, oil and gas, oil shale, sodium, potassium, phosphates, asphalt or any other type of lease obtainable under the 1920 Mineral Lands Leasing Act--to any any which has held a federal coal lease for ten years without production in commercial quantities. This provision, in light of the authority given in Section 6 of the FCLAA which provides for the termination of any lease not producing in commercial quantities within ten years of issuance, is redundant as well as being unnecessarily severe. It is a provision applied only to coal leases; no other mineral is subject to this type of stringent penalty.

Of particular concern is the requirement that holders of leases issued before the FCLAA of 1976 must be producing in commercial quantities by 1986, or be prohibited from acquiring any other federal mineral lease. Many companies with unmined leases which are dedicated future reserves would be forced to either relinquish these leases or cease bidding for other federal tracts. Although Coastal itself is not in this position today, some coal companies which are part of energy companies may well be forced to sell or forfeit their leases by 1986 in order that their company could continue to compete for federal leases in other areas, such as oil and gas. The application of the FCLAA requirements ex post facto to valid leases already issued under different terms represents an action of dubious morality and questionable legality.

Coastal supports the amendment proposed in this bill which would

correct these inequities by repealing the prohibition on issuance of leases for any mineral, including oil or gas, to anyone holding a coal lease for ten years without production in commercial quantities.

Logical Mining Units

Another provision of S.2704 would delete the requirement of the 1976 FCLAA that all property in a Logical Mining Unit (LMU) be contiguous. The original intent that an LMU be a unitized, contiguous grouping of coal lands which would be developed in an orderly and efficient manner failed to recognize that geological and legal realities often do not permit this actual contiguity. Physical problems with coal seams such as oxidized coal, eroded areas and pinchouts, as well as the separations due to existing rights-of-way can prevent formation of an efficient LMU under the current regulatory definition.

Coastal believes that removing the requirement that all lands in an LMU be actually touching would enhance the ability of mining companies to develop their properties in the desired orderly, economical and geologically efficient manner, without adversely compromising the intent of the Congress.

Forty-Year Exhaustion of Reserves

The 1976 Act also provides that all coal reserves in a Logical Mining Unit be mined within a maximum period of 40 years. The amendment being discussed today would eliminate this requirement.

Under current law, there is no other mineral which carries such

a requirement of forced depletion within a set time period. Given the long lives of power plants and those of some other industries that require coals of specific quality, it is imperative to match mine production life with facility economic life rather than an arbitrary regulatory requirement. Additionally, some leases must be mined by both surface and underground methods, with surface mining completed before the underground operation can begin. Removing the 40-year mine-out provision would not affect the diligent development or continued operations requirements of the law and would allow both mining companies and their customers to more effectively plan long-term operations and reduce the probability of premature abandonment of mineable reserves.

Payment of Advance Royalties in Lieu of Various Production Obligations

One of the more important areas addressed by S.2704 is that of diligent development and continued operation. The 1976 Act imposed very stringent production requirements on federal leases, including production in commercial quantities within ten years or the lease would terminate; and requiring continued operation of the mine as a condition for continuation of the lease. Once initial production in commercial quantities had occurred, continued operation could be waived in limited circumstances at the discretion of the secretary , for a period of not more than ten years, by payment of advance royalties. Currently, there is no provision which would provide any similar flexibility in achieving production in commercial quantities by the tenth year.

In today's regulatory environment, ten years to achieve production in commercial quantities is simply not enough. Since enactment of the 1976 legislation, there have been several statutory changes, both at the state and federal level, which have affected both coal mining companies and coal consumers. EPA and state application of the Clean Air Act and other environmental laws have greatly expanded environmental review and permitting processes. Archeological, endangered species, fish and wildlife, watershed--all are areas of concern that must now be examined in much more detail. The Surface Mining Control and Reclamation Act of 1977 also requires a very extensive permitting process before actual mining may begin.

Other factors which inject uncertainty in meeting a rigid, inflexible production start-up date include state and local regulatory decisions on utility construction and operation (Are any power plants being constructed today without "unforeseen" progress delays?), transportation factors such as rail rate deregulation result in raising costs, which reduce demand, and general economic conditions such as the downturn which we are experiencing today.

With the law as it now stands, a coal operator must be bold indeed to bid on a federal lease, pay a reasonable value as an up-front bonus (plus a considerable royalty when production begins) and then hope to put all the factors together to achieve the mandatory production dates. The amendments now being proposed would give badly needed flexibility to those operators who are

making legitimate efforts to develop their leases. Payment of advance royalties is already permitted in lieu of continued operation, and it is now being proposed that an operator could pay advance royalties in lieu of meeting the diligent development commercial quantities goal or that of continued operation. The maximum cumulative period during the life of the lease that advance royalties could be paid for any reason would remain at ten years.

The changes allowing advance royalties in lieu of both the diligent development and continued operation requirements would not only benefit the coal lease operators and their customers, but also the federal and state governments. These benefits take the form of assured royalties if leases are not producing within ten years, and avoidance of the loss of rents from the forced termination of a lease and the considerable administrative expense to the government associated with reoffering leases for sale. If, after paying advance royalties for some period, the lessee fails to achieve production and gives up the lease, both federal and state governments will have received both a bonus and royalties, yet the coal would still be in the ground and available in the future.

Detailed Operation and Reclamation Plan

Section 6 of the 1976 FCLAA added a requirement that a detailed operation and reclamation plan be prepared and submitted within three years of lease issuance. As I discussed earlier, development of a mine plan which provides for meeting all the requirements of diligent development, maximum economic recovery and resource

recovery and protection, requires that the plan be tailored to the needs of a major coal customer. Because of the time required to complete exploration of the coal deposit, the lessee will be fortunate indeed to have found and contracted with a major customer within three years of lease issuance.

The change proposed in Section 5(d) of S.2704 would eliminate only the requirement that the operation and reclamation plan be submitted within three years. The complete plan would still be required to be submitted prior to "taking any action on a leasehold which might cause a significant disturbance to the environment." The separate mining and reclamation plan required by the SMCRA of 1977 has no filing deadline, but must be submitted and approved before mining operations may begin. Approval of the amendment now proposed would allow a lessee to prepare and submit both plans contemporaneously, and with greater knowledge of the type of mining operation his customers will need.

Special Considerations for Coking Coals and Synfuels Projects

Two other sections of S.2704 propose changes to the FCLAA of 1976 which will provide relief to holders of federal leases with coking coal deposits dedicated to steelmaking and to leaseholders of coal dedicated to synfuels projects. Although Coastal has no federal coking coal leases nor involvement with the synfuels industry, we support the proposed amendments as part of an overall effort to make the coal leasing system more flexible and responsive to the needs of the coal industry, coal consumers and as an aid to economic, long-term development of publicly held resources.

Conclusion

In conclusion, I would like to reiterate that the amendments offered in this bill would serve to adapt the existing coal lease law to the realities faced by both the coal industry and the coal consumer, and would result in a more orderly, efficient development of this important national resource. In essence, the proposed changes substitute economic incentives and/or penalties for rigid and arbitrary performance regulations, which often can be proven to be contrary to the interests of all parties, including those of the American people.

Mr. Chairman, I would like to thank the committee for this opportunity to present Coastal's views on this important legislation, and I would be pleased to answer any question.

Senator WARNER [presiding]. We thank you very much for your contribution. And I am sorry if you have had any inconvenience. Because you are at the end of the list of witnesses does not mean that your testimony will be accorded any less weight.

Senator.

Senator MURKOWSKI. Thank you, Mr. Chairman. Mr. Ralph, there was reference made to coal glut in earlier testimony. Is there a coal glut in your opinion?

Mr. RALPH. No, not really. It is a soft market right now, but 6 months ago you would not have described the situation as being a coal glut. There may be more coal available, more coal planning to be produced in the west than what the market will absorb right now. This is one of the problems with the diligent development, but this was because the people acquired leases in the West because of the low sulfur coal. The coal could be put into production in a known timeframe to go from zero to four million, zero to six million tons with the installation of the drag line.

And they were able to fit the development of the Powder River Basin coal with the coming onstream of electric powerplants, particularly in the Southwest which had to go off of gas. And also people were making plans. They assumed that some things like the coal slurry pipeline might come along, because of people in the Senate like Senator Jackson and the power in the Democratic Party, would be in favor of the coal slurry pipeline and were trying to push it.

And that made a very good fit between the development of the Powder River Basin type mine with their surface mining approach and the coal slurry pipeline and the delivery to power plants in Ar-

kansas, Louisiana, and Texas. The slurry pipeline has not been passed. The railroad rates have been outrageous and they have tried to destroy the market for coal in the southwest part of the country. And so the market that was thought to be there has not developed at the rate it should have or was thought to have.

One of the problems you have right now is the apparent decline in electric power growth rates which was totally unexpected, so that you are dealing with people who had to deal with the 5- and 10-year planning horizon and then the Government has changed those factors as well as the economic factors.

So the market is still soft, but——

Senator MURKOWSKI. Do you think that is temporary due primarily to the economic softening in the country?

Mr. RALPH. That is right.

Senator MURKOWSKI. Tell me, you in your testimony expressed that you were trying to do business and if you could not make money on your investment in the coal business you would take it somewhere else. A great concern has been expressed throughout the testimony today over the speculative aspects of this leasing policy and I wonder if you would specifically address how you would suggest the legislation be tightened to address the concern of many people, in effect the industry has the prerogative of speculating at the expense of the Government and therefore the public.

You can either do this verbally or if you want to submit it later, we would appreciate that as well.

Mr. RALPH. I will try to address it later when I can give it a more considerate response. This issue of speculation I feel has been somewhat overplayed and miscast at times and——

Senator MURKOWSKI. That may be, but it is still a concern, because when it is overplayed from the standpoint of public consumption it looks like industry is ripping off the Federal Government.

Mr. RALPH. I understand, sir. As I said the leases that we have that we are developing, we acquired from another energy company, which because of the changes in the regulations they could not develop them. They sold them to us for more than what they paid for them and they have an overriding royalty, a production royalty, but they had done a lot of work between the time they had acquired the leases.

They had an engineering study done. They had participated in a recent environmental assessment and these were part of the assets that we were looking to acquire, because they had a much higher degree of certainty that these leases could be brought into production. So we were willing to pay them a premium, if you will. They were not actually speculators in the sense they just bought something and held it to rip somebody off. They actually had done an economic service and an economic activity and brought it to a higher state of value which we recognized.

Senator MURKOWSKI. What specific state of value had they brought it to?

Mr. RALPH. At the time they had submitted a mining plan which they felt was suitable, maybe not optimum, which was part of a regional EIS, and with the approval of the central Utah regional EIS, which was about to be approved at that time, then we knew that we could get a mining permit in a much shorter period of time.

Had that not existed, and we were in an area where there were no environmental studies, we would have had several years of that and that would have caused a great deal of delay.

We have had to deal with speculators in lease sales in our other mine. The way in which the Federal Government goes about its leasing promotes speculators and part of the problem is that you are dealing with two different things in the Federal leasing, at least. One is the desire to maximize economic plans from the part of the Government, the feeling that the Government has to extract every last penny out of the value of its coal holdings.

On the other side is the desire to have these resources developed for the national good and to have social and other aspects entering into the policy.

Senator MURKOWSKI. I am going to interrupt, Mr. Ralph, and declare another recess.

[Whereupon, there was a recess.]

[Subsequent to the hearing Mr. Ralph submitted the following:]

COASTAL STATES ENERGY CO.,
SUBSIDIARY OF THE COASTAL CORP.,
Nine Greenway Plaza, Houston, Tex., August 17, 1982.

Hon. JOHN W. WARNER,
Chairman, Subcommittee on Energy and Mineral Resources,
Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR WARNER: I am writing in response to the request of Senator Murkowski at the hearing of August 3, that I submit my thoughts on speculators and the federal government's leasing policies and regulations, either current or as they would be under the changes proposed in S-2704.

As to the general leasing procedures, either current or as modified by S-2704, we feel that there is little need for concern as to speculators operating in a manner detrimental to the interests of the Federal Government, either in its role of custodian of the coal resources or in its role of providing for the public interest in energy matters. The legislative and regulatory system as envisioned by the amendments under S-2704 and the newly issued Department of the Interior regulations provide sufficient requirements upon the leasee such that it is likely that only these having legitimate coal development interests would be expected to involve themselves in the leasing process. These regulations include extensive provisions as to determining a fair market value for the lease. The requirements upon the lessee for bonus payments, annual rentals, and royalties, combined with the limitations on overriding royalties and stringent permitting and development requirements, are sufficiently severe to deter speculators and in many instances discourage active coal developers. I have enclosed a copy of the recent study, Federal Coal Leasing Policy, Competition in the Energy Industries by Richard L. Gordon, Professor of mineral economics at Penn State, published by the American Enterprise Institute, which contains an excellent treatise on the subject of speculation, as well as coal leasing policies in general. The entire study should be a valuable reference source in your considerations.

There does remain, however, an area where speculators can and do operate to the detriment of active coal producers and to the interests of the Federal Government; this is the area of emergency leasing. Under the current system, for circumstances where reserves are required for maintaining an ongoing operation or to prevent bypassing and thus loss of federally owned coal, the regulations place severe qualifications upon the applicant, who by definition has to have an existing operation which is producing coal. The regulatory procedures leading up to the holding of a lease sale and the qualifications put solely upon the applicant are very vigorous. However, the lease sale is open to anyone without bidder pre-qualification. The nature of these leases is such that only the existing operator has a legitimate interest in their production and to open them to speculators solely on the premise that this will somehow enhance the achievement of fair market value is to place the government in the role of inviting rank opportunists to participate in the leasing process. The sole interest of any bidder other than the operator would be to acquire the lease that the operator had to have and then force the operator to deal with this interloper under the interloper's terms. It would be more appropriate to have emergency leasing handling under regulations similar to those as provided for in 43 CFR Part

3430 for noncompetitive leasing circumstances. We believe that procedures can be developed to eliminate opportunists from situations of this sort, while satisfying those with legitimate needs and providing fair market value to the government. An alternative approach to this problem may be to revise the abnormally restrictive acreage addition limitations currently existing under the lease modification procedures as set forth in 43 CFR Subpart 3432.

In closing, I would express my appreciation to you and Senator Murkowski for inviting me to participate in the hearing. I hope that the information which has been provided is useful to you and your committee. I would personally thank you and Senator Murkowski for the efficient and courteous conduct of the hearing. If we can be of further service to you formally or informally, please do not hesitate to request our assistance.

Very truly yours,

R. DEFOREST RALPH, Jr.

Senator WARNER. I am sorry to detain you. I have no questions, so we are completed with your testimony. We thank you.

Now, we will proceed with Mr. Michael S. Koleda, president of the National Council on Synthetic Fuels Production.

Have a safe trip back, Mr. Ralph, and we look forward to seeing you again.

Mr. RALPH. Thank you again, Senator, and I will send those written comments to you and Senator Murkowski and counsel on the speculation issue. We do have some thoughts and some recommendations for you.

Thank you.

Senator WARNER. Thank you. We apologize, Mr. Koleda, we are running a two-man track meet here and we are doing the best we can.

STATEMENT OF MICHAEL S. KOLEDA, PRESIDENT, NATIONAL COUNCIL ON SYNTHETIC FUELS PRODUCTION

Mr. KOLEDA. Thank you very much, Senator. Mr. Chairman, my name is Michael Koleda. I am president of an organization called the National Council on Synthetic Fuels Production. On behalf of the Council's 50 member companies, I would like to thank you for this opportunity to share the synthetic fuels industry's views on S. 2704.

I am going to submit my written remarks for the record and summarize somewhat here. I would like to begin by commending Senator Murkowski for his foresight in drafting a piece of legislation that addresses a number of important problems that the Mineral Lands Leasing Act poses for the development of Federal coal leases, including the unique problems that we believe are faced by a coal lessee planning to dedicate a Federal lease to synthetic fuels production.

And that is really what I want to talk to you about today. This bill goes along way toward helping us bring the vast coal deposits that we have in this country into synthetic fuels production which is, of course, one of the objectives of this country in achieving energy independence or at least a greater degree of it than we currently have.

As other witnesses before this committee have pointed out the section 3 and section 7(a) and 7(b) requirements are a decided impediment to a lessee wishing to develop a conventional coal mine and that is generally what we have been talking about so far here today.

And we support, as a council, the manner in which S. 2704 deals with these sections for such conventional coal operations. But it is important to point out, Senator, that a lessee planning to site a coal-based synthetic fuels plant relying on a dedicated Federal coal lease faces not only all of the mine related problems that confront a conventional lessee but also a number of additional problems that are unique to synthetic fuels development. And I just want to mention briefly to you what these are.

A synfuels project differs significantly from a conventional coal project and one way to put this in perspective is to look at the estimated cost. The estimated cost of a full-sized, commercial project, synthetic fuels project, and we are talking here about 50,000 barrels a day of production, stands at about $3 to $5 billion in current dollar figures and it could swell to several times that in as-spent dollars.

Of this amount of this $3 to $5 billion that would be involved in capital costs of a synthetic fuels project, only about 10 percent is for the mine. So we have been hearing today about the 10 percent and how this bill goes a long way to assisting to protect the 10 percent capital, we are talking about an additional 90 percent in the synthetic fuels operation.

Typically, it is estimated that approximately 90 percent of the investment will be for the synfuels processing plant and the associated facilities and consequently they will govern the design, the associated facilities will govern the design, construction and the startup schedule of a synthetic fuels plant.

The three areas in which a synthetic fuels operation differs from a conventional coal mine are construction time, technical uncertainty and project scale. No large scale, commercial coal base synthetic fuels plant has been completed in the United States. Therefore, no one has the experience in planning, design and construction and startup of such plants. The scale and the complexity of plants now being proposed suggest a period of well over 10 and by some estimates more than 15 years before construction of a full-sized, commercial synthetic fuels project is completed and the lease is in commercial production.

On the point of technical uncertainty, once plants are constructed, there is a degree of uncertainty on how well they will perform. When we construct a conventional coal mine, we know how it is going to perform. We don't know that with respect to a synthetic fuels plant. A period of plant shakedown can be expected as equipment is tested and, if necessary, redesigned. Environmental performance is monitored and refined and project economics are proven. This could well add up to several years in the initial start-up period.

Last, Senator, today there is much talk about project scale, what should be the appropriate size of a synthetic fuels project. The technical risk inherent in a synthetic fuels plant, coupled with its high capital cost, is driving many companies today to plan for phased project development by using smaller scale, what are called commercial modules, until the plant performance can be proven for the larger-scale production.

This trend is evident among the projects that are now before the Synthetic Fuels Corporation. A synthetic fuels project developer

may initially construct a module of from say 10,000- to 15,000-barrels-per-day capacity with an idea that after it has been proven, you then scale up by replicating this module and you are at a scale of production that is suitable given the coal lease that you have.

And with this modular approach it is clear that the production of coal in commercial quantities, as now defined, the 1 percent of reserves, could not be achieved within that 10-year period, if we are talking about a synthethic fuels, coal based operation.

These factors, which are inherent in coal based synthetic fuels plants, cannot be accommodated by the commercial production, diligent development and continued operation requirements now contained in the Mineral Leasing Act and associated regulations.

Fortunately, however, those factors are addressed by section 5——

Senator WARNER. I have a practical problem here, in which I have got 3½ minutes to get back over there. Thank you very much. We appreciate the indulgence of the witnesses with this two-man track meet.

Senator MURKOWSKI [presiding]. Mr. Koleda, I apologize as well. We have one more vote and you are the last witness.

Mr. KOLEDA. Flexibilities are required today and that is also the subject of my testimony today. Senator, what I have been saying I will not repeat other than to say that we in the synthetic fuels industry, which I am representing here as president of the National Council on Synthetic Fuels, we like the bill that you have introduced, S. 2704. We commend you for it. And we particularly are happy that it includes section 5, which takes into account the special problems that the synthetic fuels industry faces. Our main point here today, Senator, is that a synthetic fuels, coal based, synthetic fuels project is very different from a conventional coal mining operation.

It is different in scale. A conventional coal mining operation is about 10 percent of what a synthetic coal based, synthetic fuels plant operation is. The capital requirements numbers that you have been hearing today on the order of 300 million for a conventional coal mine, we are talking about 3 to 5 billion for a synthetic fuels undertaking.

So that everything that this bill does for the problems that are faced by coal mining activities we support and are helpful to the coal mining and to the synthetic fuels project. But there is the other part of it, this long lead time that is necessary to get these new plants that we have never built before that have technical uncertainties, the long planning time associated with them, and the way in which they are going to be developed, that is in modules at first. And once the modules are shown to be operable and efficient, then the idea is to replicate the modules.

So even when you have got your plant up and running after a period of perhaps 15 years, you still may not be operating at 1-percent production of your coal lease until you have further replicated this module and gotten up to full-size.

So we believe that section 5 is helpful to the synthetic fuels industry and indeed is absolutely essential if this industry is going to move ahead. We applaud you for including it in your bill and, as I said, we support it.

Before closing, I would like to recommend, however, Senator, one change in S. 2704 as introduced. Section 5 of the bill provides for a lease dedicated to the production of synthetic fuels. Production in commercial quantities can be satisfied by the initiation of construction of a synthetic fuels facility.

The Council recognizes your concerns, which this section was designed to address: First, that for synthetic fuels projects, a nonextractive definition of production in commercial quantities may be appropriate in certain cases; and, second, that many synthetic fuels projects will come into production in stages with initial coal production rates less than what might qualify as production in commercial quantities for conventional coal projects.

The Council believes these concerns are valid but perhaps can be addressed in Department of the Interior regulations rather than in legislation itself. Therefore, we recommend that the sentence containing the language quoted above may be deleted.

With this minor change to S. 2704, I believe and the industry believes the bill provides an excellent framework for Federal coal lessees to use this resource, this coal resource for synthetic fuels production as well as for conventional coal uses. S. 2704 in essence modifies the rules of the game for coal leasing so that lessees wishing to produce synthetic fuels are treated equally with conventional coal lessees.

Mr. Chairman, I thank the committee for this opportunity to present the views of the synthetic fuels industry and I would be glad to answer any questions you may have about our industry or our position on S. 2704.

[The prepared statement of Mr. Koleda follows:]

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National Council
on
Synthetic Fuels Production

TESTIMONY

OF

MICHAEL S. KOLEDA
PRESIDENT
NATIONAL COUNCIL ON SYNTHETIC FUELS PRODUCTION

SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES

COMMITTEE ON ENERGY AND NATURAL RESOURCES

UNITED STATES SENATE

AUGUST 3, 1982

1825 Eye Street, N.W. • Suite 1050 • Washington, D.C. 20006 • (202) 887-1285

Mr. Chairman, my name is Michael Koleda and I am President of the National Council on Synthetic Fuels Production. On behalf of the Council's 50 member companies I would like to thank you for this opportunity to share the synthetic fuels industry's views on S. 2704, a bill to amend the Mineral Lands Leasing Act of 1920 (MLA).

First, I would like to commend the bill's sponsor, Senator Murkowski, for his foresight in drafting a piece of legislation that addresses a number of important problems that the Mineral Lands Leasing Act poses for the development of federal coal leases, including the unique problems faced by a coal lessee planning to dedicate a federal lease to synthetic fuels production. In this regard, the Council feels that Section 5 of S. 2704 -- which provides differential lease requirements for a synfuels-dedicated lease -- strengthens the bill and recognizes the potential of the nation's vast federal coal resources to provide synthetic fuels.

The federal coal leasing statutes and regulations that S. 2704 would amend were drafted to govern leases for conventional coal mining operations. Certainly when the 1920 Mineral Lands Leasing Act and even the 1976 Federal Coal Leasing Amendments Act (FCLAA) were enacted, few if any companies were considering the effects of these laws on the production of synthetic fuels using federally-owned

COAL. IN THE INTERVENING YEARS, THE PROSPECTS FOR DEVELOPMENT OF A COAL-BASED SYNFUELS INDUSTRY HAVE INCREASED. EVEN WITH THE MORE DELIBERATE PACE NOW EVIDENT IN THE INDUSTRY DUE TO STABLE OIL PRICES AND A SLUMPING WORLD ECONOMY -- MANY IN THE INDUSTRY ARE NOW SERIOUSLY CONSIDERING COAL-BASED SYNFUELS PLANTS, SOME OF WHICH WILL RELY PARTIALLY OR ENTIRELY ON FEDERAL COAL LEASES. IT IS THEREFORE PRUDENT AND APPROPRIATE THAT THE CONGRESS REVISIT OUR COAL LEASING LAWS WITH AN EYE TOWARD SYNFUELS-DEDICATED, AS WELL AS CONVENTIONAL COAL LEASES.

THE COUNCIL SUPPORTS AMENDMENTS TO THE MLA THAT WILL REMOVE UNNECESSARY DISINCENTIVES TO COMPANIES WISHING TO LEASE FEDERAL COAL WHILE AT THE SAME TIME ASSURING THAT SPECULATIVE LEASING IS DISCOURAGED. POTENTIAL SYNFUELS DEVELOPERS ARE PRIMARILY CONCERNED WITH THE MLA'S REQUIREMENTS AND PENALTIES RELATED TO PRODUCTION IN COMMERCIAL QUANTITIES, DILIGENT DEVELOPMENT, AND CONTINUED OPERATION OF LEASES. THE MOST IMPORTANT PROVISIONS ARE SECTION 3 OF THE FCLAA AND SECTIONS 7(A) AND (B) OF THE MLA AS AMENDED BY THE FCLAA.

SECTION 3 GENERALLY HAS BEEN INTERPRETED AS PROHIBITING THE SECRETARY OF THE INTERIOR FROM ISSUING ANY LEASES (COAL, ON-SHORE OIL AND NATURAL GAS, OIL SHALE, TAR SANDS, ETC.) UNDER THE MINERAL LANDS LEASING ACT TO AN

ENTITY THAT "HOLDS A LEASE ... AND HAS HELD (THE) LEASE FOR ... TEN YEARS WHEN SUCH ENTITY IS NOT ... PRODUCING COAL ... IN COMMERCIAL QUANTITIES" FROM THAT LEASE.

SECTION 7(A) OF THE MLA SPECIFIES THAT ANY LEASE NOT PRODUCING IN COMMERCIAL QUANTITIES AT THE END OF TEN YEARS SHALL BE TERMINATED.

SECTION 7(B) OF THE MLA STATES THAT, "EACH LEASE SHALL BE SUBJECT TO THE CONDITIONS OF DILIGENT DEVELOPMENT AND CONTINUED OPERATION OF THE MINE OR MINES," EXCEPT THAT THE SECRETARY OF THE INTERIOR "MAY SUSPEND THE CONDITION OF CONTINUED OPERATION UPON THE PAYMENT OF ADVANCE ROYALTIES" FOR A TOTAL TIME NOT TO EXCEED TEN YEARS.

DEFINITIONS OF COMMERCIAL QUANTITIES AS THEY PERTAIN TO DILIGENT DEVELOPMENT AND CONTINUED OPERATIONS ARE CONTAINED IN REGULATIONS.

AS OTHER WITNESSES BEFORE THIS COMMITTEE HAVE POINTED OUT, THE SECTION 3 AND SECTION 7(A) AND (B) REQUIREMENTS ARE A DECIDED IMPEDIMENT TO A LESSEE WISHING TO DEVELOP A CONVENTIONAL MINE, AND WE SUPPORT THE MANNER IN WHICH S. 2704 DEALS WITH THESE SECTIONS FOR SUCH OPERATIONS. HOWEVER, A LESSEE PLANNING TO SITE A COAL-BASED SYNTHETIC FUELS PLANT RELYING ON A DEDICATED FEDERAL COAL LEASE FACES NOT ONLY ALL OF THE MINE-RELATED PROBLEMS CONFRONTING A CONVENTIONAL LESSEE, BUT ALSO A NUMBER OF ADDITIONAL PROBLEMS UNIQUE TO SYNTHETIC FUELS. I WOULD LIKE TO BRIEFLY OUTLINE FOR THE COMMITTEE WHY A SPECIAL CATEGORY OF

SYNFUELS-DEDICATED COAL LEASES IS NECESSARY, AND COMMENT ON THOSE SPECIFIC PROVISIONS OF S. 2104 THAT ADDRESS THIS NEED.

SYNFUELS PROJECTS DIFFER SIGNIFICANTLY FROM CONVENTIONAL COAL PROJECTS. TO PUT THIS IN PERSPECTIVE, THE ESTIMATED COST OF A FULL-SIZED COMMERCIAL PROJECT (50,000 BARRELS PER DAY OIL EQUIVALENT) STANDS AT FROM $3 TO $5 BILLION IN CURRENT DOLLARS AND COULD SWELL TO SEVERAL TIMES AS MUCH IN AS-SPENT DOLLARS. OF THIS AMOUNT, ONLY ABOUT 10 PERCENT IS FOR THE MINE. TYPICALLY, IT IS ESTIMATED THAT APPROXIMATELY 90 PERCENT OF THE INVESTMENT WILL BE FOR THE SYNFUELS PROCESSING PLANT AND ASSOCIATED FACILITIES AND, CONSEQUENTLY, THEY WILL GOVERN THE DESIGN, CONSTRUCTION, AND STARTUP SCHEDULE OF A SYNFUELS PROJECT. WITH THIS INFORMATION AS BACKGROUND, THE MAJOR FACTORS TO CONSIDER IN THE CONTEXT OF THE MLA ARE THE LONG PLANNING, DESIGN, AND CONSTRUCTION PERIOD FOR A SYNFUELS PLANT; THE TECHNICAL UNCERTAINTIES FACING PLANT OPERATIONS; AND THE SCALE OF COMMERCIAL PLANTS THAT WILL BE CONSTRUCTED.

- o Construction Time: No large-scale, commercial coal-based synthetic fuels plant has been completed in the United States. No one has experience in the planning, design, construction, and startup of such plants. The scale and complexity of plants now being proposed suggest a period of well over ten and by some estimates more than fifteen years before construction of a full-size project is completed and the lease is in commercial production.

- o Technical Uncertainty: Once plants are constructed, there is a degree of uncertainty on how they will perform. A period of plant shakedown can be expected as equipment is tested and, if necessary, redesigned; environmental performance is monitored and refined; and project economics are proven. This could add up to several years to the initial startup period.
- o Project Scale: The technical risk inherent in synthetic fuels plants, coupled with their high capital cost, is driving many companies to plan for phased project development by using smaller-scale commercial modules until plant performance can be proven for larger-scale production. This trend is evident among the projects now before the Synthetic Fuels Corporation. A synfuels project developer may initially construct a module of from 10,000-15,000 barrels per day capacity, then replicate the module after its performance has been proven, to bring the plant to its full design capacity. With this approach, it is clear that production of coal in commercial quantities as now defined (one percent of reserves) could not be achieved within ten years.

THESE FACTORS, WHICH ARE INHERENT IN COAL-BASED SYNTHETIC FUELS PLANTS, CANNOT BE ACCOMMODATED BY THE COMMERCIAL PRODUCTION, DILIGENT DEVELOPMENT, AND CONTINUED OPERATION REQUIREMENTS NOW CONTAINED IN THE MLA AND ASSOCIATED REGULATIONS. FORTUNATELY, HOWEVER, THOSE FACTORS ARE ADDRESSED BY SECTION 5 OF S. 2704, WHICH PROVIDES AN ADDITIONAL FIVE-YEAR PERIOD FOR A SYNFUELS-DEDICATED LEASE TO ACHIEVE PRODUCTION IN COMMERCIAL QUANTITIES.

FURTHER, IT IS APPROPRIATE TO PROVIDE THIS ADDITIONAL PERIOD, AS THE BILL DOES, WITHOUT REDUCING THE FLEXIBILITY THAT WOULD BE AVAILABLE TO A SYNFUELS LESSEE AS WELL AS TO A CONVENTIONAL COAL LESSEE UNDER THE OTHER PROVISIONS OF THE BILL WHICH DEAL WITH ADVANCE ROYALTY PAYMENTS IN CONNECTION WITH DILIGENT DEVELOPMENT, PRODUCTION IN COMMERCIAL QUANTITIES, AND CONTINUED OPERATION REQUIREMENTS. THESE PROVISIONS ARE INTENDED TO RECOGNIZE THAT UNFORESEEN PROBLEMS MAY ARISE WHICH PREVENT THE ATTAINMENT OF THE PRODUCTION AND OPERATING REQUIREMENTS. A SYNFUELS PLANT WILL BE NO LESS VULNERABLE TO SUCH PROBLEMS THAN A CONVENTIONAL OPERATION, AND THE SAME DEGREE OF FLEXIBILITY DURING CONSTRUCTION AND OPERATION IS REQUIRED IN BOTH CASES.

CONCLUSIONS AND RECOMMENDATIONS

The National Council on Synthetic Fuels Production believes that the Federal Coal Leasing Amendments Act of 1976 is a serious obstacle to the use of federally-owned coal for the production of synthetic fuels. Specifically, we are troubled by the performance deadlines that the Act imposes on lessees and the penalties it exacts for failure to meet these deadlines. Thus, the Council endorses the provisions of S. 2704 that address those issues:

- We favor repealing Section 3 of FCLAA because the Section 3 sanctions are punitive and a disincentive to companies that may be considering oil shale and tar sands as well as coal to produce synthetic fuels.
- The Council supports amending Section 7(a) of the MLA to permit a special category of lease for reserves dedicated to the production of synthetic fuels.
- We favor amending Section 7(a) of the MLA to extend from ten years to fifteen years the deadline for production in commercial quantities for synfuels-dedicated leases.

- o THE COUNCIL ENDORSES AMENDING SECTIONS 7(A) AND 7(B) OF THE MLA TO ALLOW THE PAYMENT OF ADVANCE ROYALTIES TO MEET THE DILIGENCE AND PRODUCTION IN COMMERCIAL QUANTITIES REQUIREMENTS AS WELL AS CONTINUED OPERATIONS REQUIREMENTS.
- o IN ADDITION, WE STRONGLY BELIEVE THAT ADEQUATE SAFEGUARDS SHOULD BE PROVIDED SO THAT THE SYNFUELS DEDICATION OF A FEDERAL COAL LEASE WILL NOT LEAD TO ABUSES CONTRARY TO THE INTENT OF THE FCLAA REGARDING TIMELY DEVELOPMENT OF FEDERAL LEASES AND THE PREVENTION OF SPECULATIVE LEASING. DEDICATION OF A SYNTHETIC FUELS LEASE SHOULD BE CONDITIONED UPON A GOOD FAITH TEST REQUIRING LESSEE PERFORMANCE AGAINST CRITERIA ESTABLISHED BY THE SECRETARY OF THE INTERIOR. FAILURE TO MEET THE GOOD FAITH TEST SHOULD RESULT IN REVOCATION OF THE SYNTHETIC FUELS DEDICATION AND REVERSION TO CONVENTIONAL LEASE TREATMENT.

MR. CHAIRMAN, BEFORE CLOSING I WOULD LIKE TO RECOMMEND ONE CHANGE IN S. 2704 AS INTRODUCED. SECTION 5 OF THE BILL PROVIDES THAT, FOR A LEASE DEDICATED TO THE PRODUCTION OF SYNTHETIC FUELS, "PRODUCTION IN COMMERCIAL QUANTITIES CAN BE SATISFIED BY THE INITIATION OF CONSTRUCTION OF A SYNTHETIC FUELS FACILITY." THE COUNCIL RECOGNIZES THE CONCERNS IDENTIFIED BY SENATOR MURKOWSKI

WHICH THIS SENTENCE WAS DESIGNED TO ADDRESS: FIRST, THAT FOR SYNTHETIC FUELS PROJECTS, A NON-EXTRACTIVE DEFINITION OF "PRODUCTION IN COMMERCIAL QUANTITIES" MAY BE APPROPRIATE IN CERTAIN CASES; AND, SECOND, THAT MANY SYNTHETIC FUELS PROJECTS WILL COME INTO PRODUCTION IN STAGES WITH INITIAL COAL PRODUCTION RATES LESS THAN WHAT MIGHT QUALIFY AS "PRODUCTION IN COMMERCIAL QUANTITIES" FOR CONVENTIONAL COAL PROJECTS. THE COUNCIL BELIEVES THESE CONCERNS ARE VALID, BUT CAN BEST BE ADDRESSED IN DEPARTMENT OF THE INTERIOR REGULATIONS RATHER THAN IN LEGISLATION. THEREFORE, WE RECOMMEND THAT THE SENTENCE CONTAINING THE LANGUAGE QUOTED ABOVE BE DELETED.

MR. CHAIRMAN, WITH THIS MINOR CHANGE TO S. 2704, I BELIEVE THE BILL PROVIDES AN EXCELLENT FRAMEWORK FOR FEDERAL COAL LESSEES TO USE THIS RESOURCE FOR SYNTHETIC FUELS PRODUCTION AS WELL AS FOR CONVENTIONAL COAL USES. S. 2704 IN ESSENCE MODIFIES THE RULES OF THE GAME FOR COAL LEASING SO THAT LESSEES WISHING TO PRODUCE SYNFUELS ARE TREATED EQUALLY WITH CONVENTIONAL COAL LESSEES.

MR. CHAIRMAN, I THANK THE COMMITTEE FOR THIS OPPORTUNITY TO PRESENT THE VIEWS OF THE COUNCIL. I WOULD BE GLAD TO ANSWER ANY QUESTIONS.

Senator MURKOWSKI. Thank you, Mr. Koleda. I appreciate your patience in the manner in which the last two witnesses were interrupted.

You heard the testimony of the Assistant Secretary Carruthers with regard to this particular portion of the bill on the synthetic fuels and the concern which he expressed relevant to the ability of the Department of the Interior to have certain flexibilities and also the assurance that the industry would not perhaps take advantage of the classification of synfuels in the sense of having the flexibility to make changes and so forth.

Have you any suggestions that would make that particular portion more palatable to the Assistant Secretary's office?

Mr. KOLEDA. I read the testimony that the Interior Department gave this morning, Mr. Chairman, and although I reserve the right to be shown to be wrong, I believe they may have misinterpreted what your bill actually says with respect to——

Senator MURKOWSKI. Would you care to submit for the record within the 10-day period a short analysis of your review of their statement?

Mr. KOLEDA. Yes, indeed.

Senator MURKOWSKI. That is suggesting how they may have taken it out of context.

Mr. KOLEDA. Yes, Mr. Chairman. I believe it is a simple misunderstanding that can be easily corrected and when it is, I think it will show why we take the position that we do.

One of the concerns that was also raised there was the question of whether the Department of the Interior would be in a position to verify the dedication of synthetic fuels and I think that, again, this is not a very well understood industry. Perhaps that is simply because we have yet to get as many plants into production as many of us feel we are going to have to get and have to get in a hurry.

The fact is when you have got a synthetic fuels project, 10 percent of the capital investment, of which is the conventional mine, and 90 percent of which is the refinery capacity that is required in order to turn that coal into liquids or gases, there is going to be little doubt in anyone's mind of whether progress is being made toward the development of a synthetic coal based, synthetic fuels project. So we believe that can be handled as well.

Senator MURKOWSKI. You suggest a change in the bill where we would provide the initiation of construction, satisfying some of the diligence requirements. Don't you feel we should mandate some construction within a time certain after the lease is dedicated to synfuel production?

Mr. KOLEDA. I think that there is no question that it is essential that we avoid any situation where a lessee applies for a dedication for synthetic fuels and then for some reason or another does not move ahead. And I think that the bill as I read it does provide the necessary penalties. If you get to year 15 on a dedicated lease and you have not met the test of having moved ahead to produce synthetic fuels, then you revert to a conventional coal lease and you pay 5 years' worth of royalties and that is a pretty steep penalty.

In other words, there is no advantage whatsoever that would be accrued to a lessee for not going ahead. And I think that is covered quite well. Now, to define what commercial quantities is, there we

may need the flexibility of how the Department of the Interior would interpret that.

Because as I said before, if you have a coal lease that is to support a 50,000 barrel a day coal base synthetic fuels facility, you are not going to necessarily, the way the industry is moving today, move directly toward a facility that would be able to produce 50,000 barrels.

You might go, for example, toward a module that would allow you to produce 10,000 barrels a day. And if it worked and proves up, then you go to replicating it. So your first initial entry with a producing synthetic fuels facility might not meet as currently defined the commercial production for the size of lease that you eventually want.

And we think that the Department of the Interior can devise a regulation to cover, language to cover the meaning of commercial production. But initiation of construction might not be the best way to define that.

Senator MURKOWSKI. We have had testimony today to the effect that the market conditions and the prevailing prices more or less dictate the rate of development of synfuels. That being the general perception in the minds of many, I would question the total accuracy of that, because if you reflect on the development of the synfuels over, say, the last decade and you relate back to the general increase in energy prices overall, it would be interesting to see where you develop a parallel correlation.

Because if you apply this same attitude today, the inference, I assume to some extent or taken by itself, would be how do you get there from here, because you have the price going up of conventional fuels but also synfuels are also still that much more above where it was at the start of the decade.

Would you relate how you see, foresee synfuels coming on in spite of the dictates that many people suggest that it will be there when the price dictates or when the reserves of lower energy fuels are consumed. How do we help the synfuels? I came down to the Committee on Environment and Public Works that I sit on and come up with all kinds of scenarios and suggestions that we may very well be at the limit of the potential coal development, as some witnesses would suggest.

That in itself would dicate the necessity of encouraging the development of synfuels. We go back and forth. It is your turn.

Mr. KOLEDA. Senator, you have asked a fairly profound question, but I am delighted that you have. Synthetic fuels production in the energy industry, synthetic fuels I suppose you might say exist somewhere in that gray overlapping area where the ability of the private sector to do it alone is beginning to end and the responsibility of the Federal Government to provide the framework to enable it to get done faster than the market can, begins.

What do I mean by that? Today, Senator, we recognize that we are and will continue to be dependent upon oil that we don't produce in this country. That might not be as much of a problem if it were not for the fact that we share that plight with our oil importing allies and the oil is coming from a region that we all understand is politically unstable and is likely to remain that way for years to come.

What do have, leaving aside the more exotic longer term energy technologies, which we all hope one day will be here in commercial quantities, what we have got is we have got our coal, our domestic oil and gas. Nuclear, as you know, is on a slow track and it does not see any signs of reviving. It has a lot of problems associated with it.

We are not producing coal and gas in this country. We are not finding it as fast as we are using it up. We have got to find out whether we can take the vast coal that we now have and turn it into liquids, either directly or through indirect processing or turn it into gas and thereby pump liquids from the system where this gas can replace it.

We have also got to find out whether this shale, this enormous quantity of shale that we have is just rock or whether it is oil And when it is upgraded it is very, very good oil. But to ask the private sector alone to do this job is to ask the boards of directors of the major corporations to look 15 and 20 years down the road and to bet their companies or a significant portion of it on their guess at what oil prices and availability are going to be that far down the line.

There is not an industry executive familiar with this problem that I speak with that does not tell me that we have to develop synthetic fuels in this country and in the same breath say but it is almost impossible for our company to put that kind of capital in that place on that kind of a bet.

This is a situtation where someone, someplace in our system has to pick up the ball and say I will take responsibility for seeing that this energy alternative is developed, recognizing that it will not be available tomorrow—it is not SPR—but it will be available 10 years after I get started and that 10 years is going to come and I am going to be glad I did it.

Industry operates on a shorter timeframe and it is not an indictment of industry; it is an explanation of the way the world works. That is why it is so terribly important that Government continue to keep in place the incentives that we now have to allow the private sector to get this job done.

We don't want the alternatives; we want the private sector to do it. And what you are doing in this bill is perhaps a small but a very important element of keeping the incentives in place to enable this industry to develop in private handling and we commend you for it.

And it is very important to the synthetic fuels industry.

Senator MURKOWSKI. Thank you very much, Mr. Koleda. I would again ask that you submit a written statement relative to the concern of the Secretary of the Interior, the Assistant Secretary Carruthers.

Mr. KOLEDA. I would be happy to do that.

Senator MURKOWSKI. We appreciate very much your testimony and I want to thank you particularly for the interruptions that have been extended through no fault of the chairman or myself but it is one of the realities of doing business around here.

With that I think with all of the witnesses' testimony, I think we have put together a worthwhile and suitable record and with that

assuming there are no more questions, we would call the hearing at an end at this time. I thank you all.

Mr. KOLEDA. Thank you, Senator.

[Whereupon, at 12:15 p.m., the hearing was adjourned.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

SUNEDCO COAL CO.
7401 W Mansfield Ave
Suite 418
Post Office Box 35B
Lakewood CO 80235
303 989 9280

August 5, 1982

The Honorable Jim Santini
House of Representatives
2429 Rayburn House Office Bldg.
Washington, D.C. 20515

Dear Mr. Santini:

The Sunedco Coal Co. is the coal acquisition and development subsidiary of the Sun Company Inc., of Radnor, Pennsylvania. As correctly noted in testimony before the U.S. House Committee on Interior and Insular Affairs, we recently completed the purchase of Utah coal properties from the Pacific Gas and Electric Co. for a price of $171 million. Among the properties acquired were certain federal coal leases which I understand PG&E had acquired in 1976 for approximately $35 million. The disparity between these two figures was held out in testimony in the House as evidence of ongoing speculation in federal coal leases and, therefore, grounds for opposing the proposed amendments to the Mineral Leasing Act.

As the purchasers of the property in question, as well as supporters of the proposed coal leasing amendments, we feel that clarification of the hearing record on this issue is essential.

At the outset I want to emphasize that we do not and cannot speak to the motives of PG&E in originally purchasing the properties in question. We believe, and I suspect the PG&E management agrees, that their initial purchase price was a bargain. Their subsequent decision to sell is based upon facts which are matters of public record before the Public Utility Commission of California. That record, I believe, indicates that declining electricity demand forecasts for the PG&E system as well as management commitment to other non-coal energy forms--nuclear, geothermal and gas--as the primary factors behind PG&E's decision to sell their Utah coal properties.

There is an additional set of important facts, which are also contained in public records held by the federal and state agencies, which also show much about PG&E's commitment to prompt development of the subject federal leases. These facts also show quite clearly why a potential purchaser such as Sun would attribute such an increase in value over the original PG&E purchase price. In anticipation of bringing these Utah properties into production in 1984, PG&E undertook the following acquisitions and developmental actions over the last six years:

11-283 O—82——10

- Acquired an additional 13,000 acres of private surface lands for facility siting, roads and rail spurs;
- Acquired related water rights (and an existing reservoir) amounting to 4600 annual acre feet;
- Conducted developmental and coal quality drilling programs for the properties;
- Completed over a three-year period, all environmental baseline data collection efforts necessary for all permits, licenses, rights-of-way and filed a completed Mining and Reclamation Plan which was deemed "complete" and "technically adequate" by the Utah Department of Oil, Gas and Mining with construction approved for June 1982;
- Completed all preliminary engineering design work for two portal entries, preparation plant, rail spur, access and haul roads, central plant facilities, sedimentation pond and diversions as well as all related surface and subsurface mining facilities.

We firmly believe that these specific and identifiable investments in and additions and improvements to the basic federal leases involved fully justified our purchase price offer. Moreover, these efforts and investments also suggest to me that PG&E was not in anyway speculating idly on federal coal properties.

I strongly urge these facts for the careful consideration of the respective House and Senate Committee members, and respectfully submit that they do not constitute evidence of rampant speculation in coal properties. I therefore further urge your favorable consideration of the proposed amendments.

Sincerely,

S. O. Ogden
President
Sunedco Coal Company

Congressional Research Service
The Library of Congress

Washington, D.C. 20540

March 1, 1982

TO :

FROM : American Law Division

SUBJECT : The Federal Coal Leasing Amendments Act of 1976 and "Diligent Development" Requirements.

You have asked us to analyze whether "diligent development" regulations proposed by the Department of Energy on December 22, 1981 comport with the Federal Coal Leasing Amendments Act of 1976 ("FCLAA").[1/]

Although the Secretary of the Interior has basic responsibility for leasing coal from Federal lands, sections 302 and 303 of the Department of Energy Organization Act[2/] transferred to the Secretary of Energy certain authorities, including the authority to promulgate regulations which relate to the:

> (1) fostering of competition for Federal leases (including, but not limited to, prohibition on bidding for development rights by certain types of joint ventures);
>
> (2) implementation of alternative bidding systems authorized for the award of Federal leases;
>
> (3) establishment of diligence requirements for operations conducted on Federal leases (including, but not limited to, procedures relating to the granting or ordering by the Secretary of the Interior of suspension of operations or production as they relate to such requirements);

1/ Pub. L. 94-377, 90 Stat. 1083, originally the Federal Coal Leasing Amendments Act of 1975, but name changed by section 8, Pub. L. 95-554, 92 Stat. 2075.

2/ Pub. L. 95-91, 91 Stat. 578-580.

(4) setting rates of production for Federal leases; and

(5) specifying the procedures, terms, and conditions for the acquisition and disposition of Federal royalty interests taken in kind.

Section 302(c) of that Act also transferred to the Secretary of Energy "all the functions of the Secretary of the Interior to establish production rates for all Federal leases."

Pursuant to these transferred authorities, the Secretary of Energy on December 22, 1981[3/] proposed regulations that redefined "diligent development" with respect to coal leases and established certain dates for the applicability of other provisions.

Although the 1982 Interior Department Appropriations Act[4/] repealed sections 302 and 303, and hence revested Interior with rulemaking authority for diligence standards, Interior has taken over the proposed regulations and extended the comment period,[5/] and your question is still relevant. To analyze these proposed regulations, it is necessary first to review the evolution of the law which they are to implement.

BACKGROUND

Coal deposits on Federal lands are leased to private parties for development under the Mineral Leasing Act of 1920 ("MLA"), as amended.[6/] Until 1976, section 7 of the MLA read in part:

> Leases shall be for indeterminate periods upon condition of diligent development and continued operation of the mine or mines, except when such operation shall be interrupted by strikes, the elements, or casualties not attributable to the lessee, and upon the further condition that at the end

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3/ 46 Fed. Reg. 62226, December 22, 1981.

4/ Pub. L. 97-100, December 23, 1981.

5/ 47 Fed. Reg. 819, January 7, 1982.

6/ Act of February 25, 1920, ch. 85, 41 Stat. 437, 30 U.S.C. 181 et seq.

> of each twenty-year period succeeding the date of the lease such readjustment of terms and conditions may be made as the Secretary of the Interior may determine, unless otherwise provided by law at the time of the expiration of such periods.

Section 31(a) of the MLA further provides:

> Except as otherwise herein provided, any lease issued under the provisions of this chapter may be forfeited and canceled by an appropriate proceeding in the United States district court for the district in which the property, or some part thereof, is located whenever the lessee fails to comply with any of the provisions of this chapter, of the lease, or of the general regulations promulgated under this chapter and in force at the date of the lease; and the lease may provide for resort to appropriate methods for the settlement of disputes or for remedies for breach of specified conditions thereof.

Sections 31(b) and (c) provide for the automatic termination by operation of law of certain leases under certain circumstances.

Therefore, you will note that the Mineral Leasing Act in 1976 required diligent development and continued operation of mines as conditions of leases issued under it, and that a lease could be cancelled through a judicial proceeding for failure to meet these conditions. Diligent development was not, however, a condition for which automatic termination of the lease was the remedy.

Note also that leases were for an indeterminate period, but could be "readjusted" at the end of each 20-year period. At these readjustment intervals, new terms and conditions could be made applicable to the lease.

Other provisions of the MLA made it possible to obtain leases without competitive bidding and to hold leases with very little expense. These provisions resulted in speculative holding of leases with little resulting production of coal. Although the Secretary had the authority to cancel leases for lack of diligent development, no regulations were passed that defined that term and no leases were cancelled.

Conditions continued to deteriorate until in 1974 only one eight-hundredth of the coal reserves under active Federal lease were actually mined.[7/] The Department of the Interior recognized that the growing body of criticism of the coal leasing program was well founded and beginning in May of 1971 imposed a moratorium on coal leasing while reforms were studied and proposed.

In December, 1974, prior to enactment of FCLAA, Interior proposed regulations to define diligent development more specifically. These proposed regulations later were modified to include a 10 year development period.[8/] It is interesting to note that these tougher requirements were proposed for pre-1976 leases administratively, before Congress acted.

The 94th Congress enacted the Federal Coal Leasing Amendments Act to address many of the problems of the Federal coal leasing program. The details of many of these important issues, such as the creation of logical mining units ("LMUs") will not be discussed here.

FCLAA amended section 7 of the MLA to strengthen the diligent development requirements, to provide that leases would have a basic 20-year term and a 10-year readjustment period. The pertinent text is:

> SEC. 6. Section 7 of the Mineral Lands Leasing Act (30 U.S.C. 207) is amended to read as follows:
>
> "SEC. 7. (a) A coal lease shall be for a term of twenty years and for so long thereafter as coal is produced annually in commercial quantities from that lease. Any lease which is not producing in commercial quantities at the end of ten years shall be terminated. The Secretary shall by regulation prescribe annual rentals on leases. A lease shall require payment of a royalty in such amount as the Secretary shall determine of not less than 12½ per centum of the value of coal as defined by regulation, except the Secretary may determine a lesser amount in the case of coal recovered by underground mining operations. The lease shall include such other terms and conditions as the Secretary shall determine. Such rentals and royalties and other terms and conditions of the lease will be subject to readjustment at the end of its primary term of twenty years and at the end of each ten-year period thereafter if the lease is extended.
>
> Regulation, Royalty.
>
> Terms and conditions.

7/ See comments of Rep. Mink, 122 CONG. REC. 486 (1976).

8/ 39 Fed. Reg. 43229 (1974), modified at 40 Fed. Reg. 60070 (1975).

"(b) Each lease shall be subject to the conditions of diligent development and continued operation of the mine or mines, except where operations under the lease are interrupted by strikes, the elements, or casualties not attributable to the lessee. The Secretary of the Interior, upon determining that the public interest will be served thereby, may suspend the condition of continued operation upon the payment of advance royalties. Such advance royalties shall be no less than the production royalty which would otherwise be paid and shall be computed on a fixed reserve to production ratio (determined by the Secretary). The aggregate number of years during the period of any lease for which advance royalties may be accepted in lieu of the condition of continued operation shall not exceed ten. The amount of any production royalty paid for any year shall be reduced (but not below 0) by the amount of any advance royalties paid under such lease to the extent that such advance royalties have not been used to reduce production royalties for a prior year. No advance royalty paid during the initial twenty-year term of a lease shall be used to reduce a production royalty after the twentieth year of a lease. The Secretary may, upon six months' notification to the lessee cease to accept advance royalties in lieu of the requirement of continued operation. Nothing in this subsection shall be construed to affect the requirement contained in the second sentence of subsection (a) relating to commencement of production at the end of ten years. Advance royalties.

"(c) Prior to taking any action on a leasehold which might cause a significant disturbance of the environment, and not later than three years after a lease is issued, the lessee shall submit for the Secretary's approval an operation and reclamation plan. The Secretary shall approve or disapprove the plan or require that it be modified. Where the land involved is under the surface jurisdiction of another Federal agency, that other agency must consent to the terms of such approval.". Operation and reclamation plan, submittal to Secretary.

Note that although neither the term "diligent development" nor "commercial quantity" is defined in the Amendments, a lease may be "terminated" (ended by operation of law and contested through administrative proceedings rather than the judicial cancellation proceeding), if a lease is not producing in commercial quantities at the end of ten years. Other provisions of the Amendments also lent impetus to production. Section 3 of the Amendments amended section 2 of the MLA to read: "No lease sale shall be held unless the lands containing the coal deposits have been included in a comprehensive land-use plan and such sale is compatible with such plan."

Section 5 of FCLAA further amended section 2 of the MLA to add provisions authorizing the creation of logical mining units and requiring diligent development of them:

Logical mining unit. 30 USC 201. 30 USC 202a. Hearing.

(b) Section 2 of the Mineral Lands Leasing Act is amended by the addition of the following new subsection at the end thereof:

"(d)(1) The Secretary, upon determining that maximum economic recovery of the coal deposit or deposits is served thereby, may approve the consolidation of coal leases into a logical mining unit. Such consolidation may only take place after a public hearing, if requested by any person whose interest is or may be adversely affected. A logical mining unit is an area of land in which the coal resources can be developed in an efficient, economical, and orderly manner as a unit with due regard to conservation of coal reserves and other resources. A logical mining unit may consist of one or more Federal leaseholds, and may include intervening or adjacent lands in which the United States does not own the coal resources, but all the lands in a logical mining unit must be under the effective control of a single operator, be able to be developed and operated as a single operation and be contiguous.

Reserves.

"(2) After the Secretary has approved the establishment of a logical mining unit, any mining plan approved for that unit must require such diligent development, operation, and production that the reserves of the entire unit will be mined within a period established by the Secretary which shall not be more than forty years.

"(3) In approving a logical mining unit, the Secretary may provide, among other things, that (i) diligent development, continuous operation, and production on any Federal lease or non-Federal land in the logical mining unit shall be construed as occurring on all Federal leases in that logical mining unit, and (ii) the rentals and royalties for all Federal leases in a logical mining unit may be combined, and advanced royalties paid for any lease within a logical mining unit may be credited against such combined royalties.

"(4) The Secretary may amend the provisions of any lease included in a logical mining unit so that mining under that lease will be consistent with the requirements imposed on that logical mining unit.

"(5) Leases issued before the date of enactment of this Act may be included with the consent of all lessees in such logical mining unit, and, if so included, shall be subject to the provisions of this section.

Regulation.

"(6) By regulation the Secretary may require a lessee under this Act to form a logical mining unit, and may provide for determination of participating acreage within a unit.

Note that the effect of items (4) and (5) is that existing leases may be amended upon inclusion in a logical mining unit. The applicability of the new provisions to these existing leases is clear.

Similarly, section 3 of FCLAA in amending section 2(a) of the MLA also addresses existing leases:

> The Secretary shall not issue a lease or leases under the terms of this Act to any person, association, corporation, or any subsidiary, affiliate, or persons controlled by or under common control with such person, association, or corporation, where any such entity holds a lease or leases issued by the United States to coal deposits and has held such lease or leases for a period of ten years when such entity is not, except as provided for in section 7(b) of this Act, producing coal from the lease deposits in commercial quantities. In computing the ten-year period referred to in the preceding sentence, periods of time prior to the date of enactment of the Federal Coal Leasing Amendment Act of 1975 shall not be counted.

In other words, a lessee who held an existing lease and did not begin commercial quantity production within ten years of the passage of the FCLAA could not obtain any other leases "under the terms of this Act". This latter language occasions your second inquiry to us and will be discussed later in this memorandum.

Clearly, therefore, coal leases issued after the 1976 Amendments were to be treated differently from those that had been issued before. It is not clear, however, from the face of the Amendments whether all of the provisions also were to apply to leases issued before August 4, 1976, the effective date of the Amendments. The applicability to pre-1976 leases of certain of the new provisions is noted in the discussion above. The applicability of the clarified diligent development and continued operation requirements of the amended section 7(b), and the new requirement that any lease which is not producing in commercial quantities at the end of ten years be terminated is not so clear. On the one hand, pre-1976 leases already were subject to diligent development and continued operation requirements, and were subject to cancellation for failure to comply with any of the provisions of the Mineral Leasing Act. One could argue that it was not unreasonable to apply the ten year terminarion provision to pre-1976 leases, since the new provision only clarified and strengthened terms already in the pre-1976 leases. Also, other provisions in the 1976 Act clearly worked an amendment of the terms of existing leases - for example the authority for the Secretary to change the terms of existing leases if the lands that were the subject of those leases were included in a logical mining unit. In addition, the termination provision was worded: "Any lease which is not producing in commercial quantities at the end of ten years shall be terminated." (emphasis added). Furthermore, the time frame appears generous - a lessee would have ten years within which to achieve production of commercial quantities of coal before termination.

On the other hand, one also could argue that the general posture of the MLA is to make new provisions applicable to existing leases only as they are incorporated into the lease at the time of readjustment. Arguably too, to do otherwise raises due process concerns, especially with respect to a new termination provision.

Obviously, whether the section 7 provisions are interpreted as applying to all leases as of the effective date of the Amendments, or as applying to pre-1976 leases only after their readjustment dates determines when the ten year period for possible termination begins to run.

DEPARTMENT OF THE INTERIOR REGULATIONS

The Department of the Interior promulgated regulations interpreting the amended section 7 that differ from those proposed by the Department of Energy. Those of Interior defined "diligent development" for pre August 4, 1976 leases as including production in commercial quantities from logical mining units before June 1, 1986. Because 43 CFR 3475.5 states that "[e]ach lease shall automatically be considered to constitute an LMU on the effective date of the lease or June 1, 1976, whichever is later", this definition applies to all pre-1976 leases. Therefore, the regulations allow pre-August 4, 1976 leases only a ten year period within which to comply or be subject to cancellation, rather than termination, under 43 CFR 3452.2-1. Pre-1976 leases are, however, given opportunities to extend the ten year period. The pertinent regulations are as follows:

43 CFR 3400.0-5 Definitions:

(m) "Diligent development" means (1) for any lease issued after August 4, 1976, the timely preparation for and initiation of coal production from the LMU of which the lease is a part so that coal is actually produced in commercial quantities by the end of the tenth year from the effective date of the lease; or

(2) For any lease issued before August 4, 1976, the timely preparation for and initiation of coal production from the LMU so that coal is actually produced in commercial quantities before June 1, 1986, except that the period of time during which production of coal in commercial quantities must be achieved may be extended as provided in 43 CFR 3475.4.

(l) "Commercial quantities" as used in paragraph (m) means:

(1) For any lease issued after August 4, 1976, an amount of production equal to one percent of the LMU reserves; or

(2) For any lease issued before August 4, 1976, an amount of production equal to one-fortieth of the LMU reserves.

§ 3475.4 Diligent development and continued operation.

(a) Each lease shall require (1) diligent development, and (2) either (i) continued operation except when operations under the lease are interrupted by strikes, the elements, or casualties not attributable to the lessee, or (ii) in lieu thereof, when the Secretary determines that the public interest will be served, payment of an advance royalty as described in § 3473.3-2(b) of this title.

(b) For coal leases issued before August 4, 1976, the 10 lease-year period for achieving diligent development may be increased as follows:

(1) Upon application by the lessee, the 10 lease-year period shall be extended by an amount of time equal to the period during which diligent development is, in the opinion of the Secretary, significantly impaired by (i) a strike, the elements, or casualties not attributable to the lessee, (ii) an administrative delay in the Department which is not caused by the lessee's action, and (iii) extraordinary circumstances not attributable to the lessee and not foreseeable by a reasonably prudent operator. In determining whether any of the conditions listed in paragraph (b)(1) (i), (ii), or (iii) of this section occurred and whether one or more of those conditions did, in fact, significantly impair diligent development, the Secretary's finding shall be final. The Secretary shall, however, not find to be an extraordinary circumstance under paragraph (b)(1)(iii) of this section any condition arising out of normally foreseeable business risks such as: fluctuations in prices, sales, or costs, including foreseeable costs of compliance with requirements for environmental protection; commonly experienced delays in delivery of supplies or equipment; or inability to obtain sufficient sales.

(2) Upon application by the lessee, the Secretary may grant one extension, not exceeding five years, of the 10 lease-year period because of (i) time needed to complete development of advanced technology, e.g., in situ, gasification or liquefaction processes; (ii) the magnitude of the project (ordinarily magnitude means a mine in which the production in the first year after the end of the extended period for diligent development is expected to be at least two million tons if an underground mining operation or five million tons if a surface mining operation); or (iii) a contract which is a firm commitment for the sale or use of the first one-fortieth of the LMU reserves after the 10-year period. Regardless of the reason for granting an extension, the lessee shall produce the first one-fortieth of the LMU reserves before the end of the extended term.

(c) At the time when the Secretary grants an extension under paragraphs (a) and (b) of this section, the lessee shall be notified of the revised date by which coal shall be produced in commercial quantities.

§ 3452.2 Cancellation.

§ 3452.2-1 Cause for cancellation.

(a) The authorized officer, after compliance with § 3452.2-2 of this title, may take the appropriate steps to institute proceedings in a court of competent jurisdiction for the cancellation of the lease if the lessee: (1) Fails to comply with the provisions of the Mineral Leasing Act of 1920, as amended; (2) fails to comply with the general regulations in force on the date of the lease or in force on the effective date of any readjustment of the terms and conditions of the lease, or with regulations issued after lease issuance and readjustment but made applicable under the terms of the lease; or (3) defaults in the performance of any of the terms, covenants, and stipulations of the lease.

(b) A waiver of any particular default, breach or cause of forfeiture shall not prevent the cancellation and forfeiture of the lease for any other default, breach or cause of forfeiture, or for the same cause occurring at any other time.

(c) Any lease issued before August 4, 1976, on which the lessee does not meet the diligent development requirements or any lease whenever issued on which the lessee does not meet the continued operation requirements shall be subject to cancellation in whole or in part. In deciding whether to initiate lease cancellation proceedings under this subsection, the Secretary shall not consider adverse circumstances which arise out of (1) normally foreseeable costs of compliance with requirements for environmental protection; (2) commonly experienced delays in delivery of supplies or equipment; or (3) inability to obtain sufficient sales.

§ 3452.2-2 Cancellation procedure.

The lessee shall be given notice of any default, breach or cause of forefeiture and be afforded 30 days to correct the default, to request an extension of time in which to correct the default, or to submit evidence showing why the lease should not be cancelled.

§ 3452.3 Termination.

(a) Any lease issued after August 4, 1976, shall be terminated if the lessee does not meet the diligent development requirements.

(b) Should a lease be cancelled or terminated for any reason, all deferred bonus payments shall be immediately payable and all rentals and royalties, including advance royalties, already paid or due, shall be forfeited to the United States.

DEPARTMENT OF ENERGY PROPOSED REGULATIONS

The regulations proposed by the Department of Energy also treat pre-August 4, 1976 leases differently from those issued on or after that date, but produce different results. Leases issued on or after August 4, 1976 would be required to produce coal in "commercial quantities" within ten years from the effective date of the lease to meet the requirement for diligent development. Pre-August 4, 1976 leases, however, would not have to meet the June 1, 1986 deadline established by Interior. Rather, the ten year period within which diligent development must be achieved would begin to run from the next readjustment date occurring after August 4, 1976. Furthermore, the time within which an LMU must be developed will depend on the dates of individual leases in it. The DOE introductory material states: "The bulk of those leases are scheduled for readjustment in the mid-80's, but some are scheduled as late as 1995. Thus, this proposal would spread the initial production requirement over a longer time horizon. This modification is intended to promote more timely, orderly, and efficient development and production of leased reserves and allow development to coincide more closely with increases in coal market demand."[9/]

In addition, the proposed regulations also lower the volumes of coal necessary to constitute "commercial quantities", and make other changes. A complete copy of these regulations is attached, but the definition of diligent development is as follows:

> "Diligent Development" means the production of coal in commercial quantities prior to the end of the diligent development period.
>
> "Diligent Development Period" means a period which shall begin on either:
>
> (1) The effective date of the lease for all leases issued on or after August 4, 1976;
>
> (2) The effective date of the first lease readjustment after August 4, 1976, for all leases issued prior to August 4, 1976, and readjusted after that date; or
>
> (3) For all LMU's, the most recent of the dates established under paragraph (1) or (2) of this definition for each Federal lease included in the LMU and occurring prior to the time of LMU approval, unles the LMU contains a lease issued prior to August 4, 1976, that has not been readjusted between August 4, 1976, and the date of LMU approval, in which case the diligent development period for the LMU shall begin on the date of approval of the LMU; and which shall terminate upon the production of coal in commercial quantities or at the end of ten years, whichever occurs first, unless the period is extended as provided in § 378.306.

9/ 46 Fed. Reg. 62228 (December 22, 1981).

Furthermore, a holder of a pre-August 4, 1976 lease that has not been readjusted after that date may elect to be governed until readjustment by the lease clause on minimum production requirements rather than the new development requirements.

Therefore, the two sets of regulations present two very different interpretations of the relationship of diligent development requirements to leases existing on August 4, 1976. Since the statute itself did not expressly address the question, you have asked that we research the legislative history as to the intent of Congress in this regard.

LEGISLATIVE HISTORY

Although it is a rule of statutory construction that if the court can ascertain the "plain meaning" of a statute, it may not rely on extraneous legislative history,[10/] courts typically do consider that history - either to ascertain if there is in fact a plain meaning, or to bolster that conclusion. In all instances, the purpose is the ascertainment of congressional intent.

Particular legislative history materials are given differing weights when used by a court to evaluate the meaning Congress intended a provision to have. Generally, explanations contained in a conference or committee report are considered most persuasive,[11/] followed by relevant material from the floor debates. Remarks of various members, however, are not necessarily of equal weight. The remarks of a conference committee chairman or a floor manager explaining a committee report or provision are entitled to more weight than are the remarks of a member not on the reporting committee. So too, the

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10/ 2A Sutherland Statutory Construction (Sands, 4th ed. 1973), § 48.01.

11/ Ibid., § 48.06, at 203-204.

remarks of the sponsor of a measure are given more weight than those of a member made simply in support of or in opposition to a measure.[12/]

Application of the "rules" of statutory construction varies greatly depending on the particular problem and context, and predictions as to a court's ultimate analysis of legislative history are tenuous at best. Not infrequently opposite results can be reached by applying the general rules of construction. With these principles and caveats in mind, we turn to the legislative history pertinent to the issue you have raised.

The Federal Coal Leasing Amendments Act of 1976 was S. 391 as amended in the House to substitute the text of the House bill, H.R. 6721. The Senate concurred in the House amendment and therefore a conference committee was not necessary. H.R. 6721, as amended in committee, contained the prohibition against the Secretary's issuing any other leases to a lessee who held a lease without producing coal in commercial quantities for a period of 15 years and the termination provision for failure to develop a lease to production of commercial quantities also was worded as a 15 year term. Both provisions were amended on the floor to read 10 years.

S. 391 as amended by committee included a title addressing surface mining issues as well as a title addressing federal coal leasing issues. As to the latter, the bill was similar to that of the House in many respects but did not contain the prohibition against issuing additional leases to a lease holder who did not bring a lease into production within a certain amount of time. Section 103 of the bill contained the principal provision as to diligent development:

> Each lease issued under this Act shall provide that such lease is subject to termination for failure to develop the lease with due diligence. At the time a tract is offered for lease the Secretary shall publish a proposed

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12/ Ibid., § 48.13 at 216-217.

> time schedule for development of the lease. Unless relieved of the obligation by the Secretary for good cause, failure to develop the lease according to said schedule shall be prima facie evidence of failure to develop with due diligence. The time schedule shall provide for development within seven years except for good cause which shall be stated by the Secretary.

The Senate bill also established a 20-year term and 10-year adjustment periods.

In the section-by-section analysis of the bill it was noted that a primary concern was bringing federal coal leases into actual production and that the provisions of the bill would alleviate the problem at least with respect to future leases:

> The Committee believes that the purpose of leasing Federal coal is to have that coal produced to meet the nation's energy needs. The existing law has been interpreted to allow lessees to hold leases without production for as long as they see fit. The amendment would prevent this from happening under future leases.
>
> The Committee expects that the Secretary will define by regulation "production" to assure that leases are maintained only by bona fide commercial development and not by token production. 13/

The question of bringing existing leases into production also was referred to in the discussions on the Senate floor. Senator Randolph submitted an amendment calling for the Secretary to report to Congress on the status of development of outstanding coal leases and to recommend additional administrative or legislative action. The Senator noted:

> The bill under consideration requires production within seven years in order to obtain a new lease. This provision would assure the production of coal in an orderly fashion. Similar assurances should be provided for existing leases to prevent them from being held indefinitely as a speculation against higher profits in the future. 14/

13/ S. Rep. No. 94-296, 94th Cong., 1st Sess. 15 (1975); reproduced at 121 CONG. REC. 26370 (1975).

14/ 121 CONG. REC. 26377 (1975).

Senator Randolph asked whether the development provisions of the bill applied to old leases.

Senator Metcalf, in responding to this question, indicated that there was some confusion as to the power of Congress to impose new development requirements on existing leases:

> I share the Senator's concern about the need to obtain production from the Federal coal lands which are already under lease. The background of the Federal coal leasing program which led to this existing situation has been explored in some detail by the committee at its hearings this year and last. This background is summarized in the committee's report.
>
> Much of the problem lies with the provisions of the existing law and the terms of leases issued under it. The changes proposed by S. 391 are designed to assure that production will take place within a reasonable time by any leases issued in the future. The provisions in S. 391 dealing with logical mining units should help to encourage production of some existing coal leases.
>
> The Interior Department has assured us that they will vigorously enforce the requirements of existing leases for diligent developments. The Department has proposed changes to its regulations to assist in this effort. This is a difficult situation to resolve by legislation because validly issued leases convey rights to the lessees which may be protected under the Constitution. Each case may differ. Thus, we must encourage the Secretary of Interior to fulfill his commitments to vigorously enforce provisions of existing leases.
>
> Mr. RANDOLPH. Mr. President, I appreciate the assurance of the able Senator that that is the intent of the bill, in response to the questions that I have asked. I am very grateful for the attention given by the Senator from Montana and others who have explored the importance of this matter.
>
> Mr. METCALF. If the Senator will yield further, it was a concern of many members of the committee, including the distinguished Senator from Colorado presently presiding (Mr. HASKELL) that we do enforce the existing leases, that we require these people to mine the coal and get rid of these speculators that the distinguished Senator from West Virginia mentioned.

15/

S. 391 was passed by the Senate on July 31, 1975 without further changes related to this issue.

Non-production from both existing and future leases also was of central concern in the House.

The House Report 16/ reviewed both the history of inadequacies in the federal coal leasing program and the recent efforts of the Department of the Interior to remedy the situation. The report spoke clearly of the lack of

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15/ Ibid. at 26378.

16/ H.R. Rep. No. 94-681, 94th Cong. 1st Sess. (1975).

enforcement of "diligent development" and "continued operation" requirements with the result that existing leases were not producing and were held by speculators. The discussion also addressed the question of existing versus new leases and the effect of the new requirements:

> The problems of speculation are addressed directly by H.R. 6721, which requires termination of any lease which is not producing in commercial quantities at the end of 15 years. Old leases (those existing on the date of enactment of the 1975 Act) would be exempt from this provision, except to the extent it might be made applicable upon readjustment of lease terms, but the lessees would be prohibited from acquiring any new Federal leases should they continue to hold old leases 15 years after enactment without producing therefrom. Additionally each lease will be subject to diligent development and continued operation. 17/

The section-by-section analysis states that the amendment to 2(a) of the MLA "would bar the issuance of new leases to any individual or corporations that have held a lease for a period of 15 years, beginning on the date of enactment of the Federal Coal Leasing Amendments Act of 1975, without producing coal therefrom."[18/] This portion of the report does not add further clarification on the applicability of the amendments to section 7 of the MLA and existing leases.

The problem of non-production in general and of promoting greater production from lands under existing leases also was discussed on the floor of the House.

Representative Mink, the chairman of the Subcommittee on Mines and Mining of the House Committee on Interior and Insular Affairs that wrote the bill, made the presentation on the floor. She began by discussing statistics as to the number of acres presently under lease and went on to state:

17/ Ibid., at 15.

18/ Ibid. at 22.

> These statistics would appear to cast considerable doubt on claims by the administration that there exists an urgent need to lease more Federal coal lands for development. However, it is not our desire to engage in political debate over estimated future needs. Nor do we wish to trigger sticky constitutional questions involving the taking of legislatively conferred rights by reacting to the deficiencies of current leasing law within the retroactive application of tough new lease standards and terms to lessees who legally gained their rights relying on the provisions of current law. Rather, Mr. Chairman, it is the purpose of the legislation before us today to insure that any future leasing and lease administration is carried out under congressionally mandated guidelines that will require a fair return to the public, and diligent, efficient, and orderly development and production of the coal resources in a leasing tract, and adequate environmental and social planning. 19/

> In summary, Mr. Chairman, let me emphasize that the provisions of H.R. 6721 are intended to correct the inadequacies of present law which permit the speculative holding of leases and provide a poor return to the public. The 533 existing Federal leases would be unaffected by the bill except to the extent its provisions are made applicable upon the periodic ten year readjustment of lease terms, or upon the inclusion of an existing lease in a logical mining unit. The only other sanction imposed on existing leases would be a prohibition on leasing any additional Federal tracts to an entity which holds a nonproductive lease 15 years after the date of enactment of this bill. Existing leaseholders would therefore have at least until 1991 before this sanction would apply. 20/

That the amendments to section 7 of the MLA as to termination for failure to develop would not apply to existing leases was repeated by others who commented on the bill. For example, Representative Drinan stated:

> H.R. 6712 would require a termination of any coal lease which is not producing in commercial quantities at the end of 15 years.

19/ 122 CONG. REC. 488, elaborating on a similar statement at 486 (1976).

20/ Ibid., at 489.

> Leases already in existence would be exempt from this provision, but the lessees could not acquire any new leases while they continue to hold nonproducing tracts. 21/

In the course of debate over changing the termination period from 15 to 10 years, Rep. Ruppe, also a member of the House Interior Committee, spoke on the development requirements:

> Let me say one more thing, Mr. Chairman. At the present time there is actually no specific time limit during which or at the end of which a lease has to be underway or has to be mined. So it seems to me we are going a long way from taking a situation where today there is no time limit required whatsoever in developing a lease to legislation that we have before us that would require this development in 15 years.
>
> There is also a standby or backup provision. The old legislation which we hope to amend today does require diligent development of a coal lease. I might say that diligent development, while it is in the legislation today, has never been used or has never been required by the Department of the Interior. But even today, with the clause requiring diligent development, the Interior Department could get after those companies who have leases but who simply have ignored the legislation or have delayed the mining of coal over a period of years.
>
> So let me say that there is diligent development required today. There would be diligent development required in the legislation that we pass here, even under the 15-year overall limitation.
>
> We do in this legislation require a lease to be mined within 15 years, but there is also a provision in the legislation requiring prompt development or diligent development, so anyone who has a lease secured on Federal property still has to meet the terms of the present legislation calling for diligent development, and that alone, in combination with the overall 15-year limitation, in my opinion offers necessary but proper safeguards.

22/

Rep. Mink entered the debate at this point in support of the ten-year termination period that ultimately was adopted. She noted that the subcommittee had felt that a 10-year period was "more than adequate" and that the 15-year figure was a result of a compromise that considered the preferences of the administration. However, she went on to note, the administration now also had agreed that a 10-year limitation was reasonable. She quoted the definition of "diligent development" from the Interior regulations proposed December 31, 1975, after committee action was already concluded:

21/ Ibid., at 497.

22/ Ibid., at 503.

> Diligent Development of a Federal lease means the timely preparation for the initiation of production of coal from the LMU of which the lease is a part so that one-fortieth of the LMU reserves associated with that lease are extracted within a period of ten years from (the date of this regulation) or from the date of the lease, whichever occurs later. 23/

The balance of the discussion between Reps. Mink and Ruppe centered on the fact that requiring one-fortieth of the reserves to be extracted still was not very much production. Cong. Ruppe noted that the production level was so low as to amount to "not much more than token compliance" and that in view of the low production requirements 10 years was certainly ample.[24/]

ANALYSIS

Although the committee report and the pertinent comments made on the floor of both houses are not clear as to the details of the effects the new provisions would have on existing leases, it seems fair to conclude that 1) not all of the new provisions would apply to existing leases, but that 2) existing diligent development requirements would continue to apply and would be toughened as to all leases through new regulations that reflected the clarified policy of Congress to require actual production.

The best reading of the floor comments on existing leases would seem to be that some definition of genuinely diligent development would be made applicable to all leases, but the stringent new measures such as the changes in royalty rates and the automatic termination of leases for failure to develop new leases within the 10-year period would only apply to pre-1976 leases upon readjustment, or if they were included in an LMU.

23/ Id.

24/ Ibid., at 504.

The differences in regulatory interpretation have arisen in belatedly defining diligent development requirements and specifying how those requirements relate to the new 10-year termination provision.

Interior has required diligent development of all leases within (basically) 10 years, with cancellation the remedy to be applied to pre-1976 leases after certain opportunities for extension have been exhausted. Automatic termination for failure to diligently develop would be the remedy only for post-1976 leases, or those pre-1976 leases included in a LMU or which incorporate the termination condition after readjustment.

Arguments could be made based on the floor statements that Interior's current regulations requiring diligent development under existing leases within 10 years are overly stringent in light of the comments indicating that the prohibition against obtaining additional leases together with (somehow) tightened requirements as to development were meant to be the means of encouraging production from existing leases. Under this reasoning, the 10-year period must be linked to the termination provision and become applicable to existing leases only after a readjustment date. On the other hand, one also could argue that diligent development has always been required in the law, there is indication that 10 years is an ample period, that extension of the time period was available to pre-1976 leases, that the remedy in the case of those leases was cancellation rather than more stringent automatic termination, and that Congress expressed awareness of Interior's redefinition of diligent development when FCLAA was being considered.

DOE's proposed regulations make the 10-year termination period applicable to pre-1976 leases only after a readjustment date, but also define diligent development in terms of that time period. This definition means that termination rather than cancellation is the remedy for all failure to

diligently develop and also postpones meaningful development requirements on virtually all pre-1976 leases until after the next readjustment date of each.

To phrase the regulations so as to apply the 10-year development/termination requirement to pre-1976 leases only after those conditions are included in the leases after readjustment appears to comport with the legislative history. (Though an argument can be made, as above, that a 10-year period not linked to termination is reasonable to include in a definition of diligent development even as to pre-1976 leases). But the DOE regulations arguably also make development a voluntary option for the pre-1976 lessees until dates far in the future.

Proponents of the DOE regulations justifiably could note that the legislative history contains many statements to the effect that the new provisions are not to apply to existing leases until after readjustment. But it must also be noted that there are many statements that assume that the then current statutory conditions of diligent development would be toughened as to existing leases to reflect the policies of the 1976 Amendments. At the time Congress was considering those amendments, Interior already had begun to do so - and was basing development requirements on a 10-year period. Furthermore, the more stringent regulations of Interior have been in effect to date without congressional "correction".

Although the question is arguable, the fact that the DOE regulations postpone development of existing leases for so long and also propose lowered definitions of productions levels, raises serious questions as to the compliance of the proposed regulations with the repeatedly stated intent of Congress to strengthen the development requirements of the MLA and to spur actual, non-token production of the Federal coal resources.

SECTION 2(a) SANCTION

You also have asked us whether the prohibition in section 2(a) of the Mineral Leasing Act, as amended by section 3 of FCLAA, which states that the Secretary shall not issue a lease "under the terms of this Act" to anyone holding a non-producing coal lease, precludes such a holder from obtaining oil and gas leases as well as additional coal leases.

The "Act" referred to in section 2(a) is, of course, the Mineral Leasing Act which does govern the leasing of oil and gas (and certain other minerals) as well as coal. Therefore it seems that the "plain meaning" of the new language added to section 2(a) is that the sanction encompasses all Federal leases under the Mineral Leasing Act.

However, section 2, to which the new provision was added, is captioned "COAL" and only provisions pertinent to the leasing and management of federal coal deposits follow until the next heading. This structural organization may suggest that the new provision is only relevant to coal leases issued under "the terms of this Act", or it may be that the provision applies to all MLA leases and is placed in section 2 only because it applies to certain coal lease holders.

As noted earlier in this memorandum, this provision originated in the House bill, H.R. 6721, the text of which ultimately was enacted. The House report does not elaborate on this point, stating only that the "amendment would bar the issuance of new leases to any individual or corporations that have held a lease for a period of 15 years, beginning on the date of enactment of the Federal Coal Leasing Amendments Act of 1975, without producing coal therefrom."[25/]

25/ H.R. Rep. No. 681, 94th Cong., 1st Sess. 22 (1975).

Most of the instances in which the provision was referred to on the floor have been reproduced in the previous section of this memorandum, and did not specifically address the possibility that non-coal leases could be included. Some of the comments, however, seemed to imply that only additional coal leases were meant to be prohibited.[26/] Arguably, had Congress meant leases other than the coal leases that were the subject of the legislation, this broader intent would have been expressed. On the other hand, perhaps Congress assumed the breadth of the language was clear on its face.

In short, a definitive answer to your second question is not possible. A court could find either a broad meaning based on the language itself, or a more narrow meaning based on the structure of the statute and the comments on the floor.

We hope this information is helpful to you.

Pamela Baldwin
Legislative Attorney

26/ See, for example, the comments of Rep. Mink, 122 CONG. REC. 489 (1976).

determine whether the rule is a major rule within the meaning of that Executive Order. If it is determined that the action constitutes a major rule, the agency is further required to prepare a Regulatory Impact Analysis describing the principal benefits and costs of the rule, net benefits, and alternative approaches that could substantially achieve the same regulatory goal. For the purpose of the Order, "major rule" means any regulation that is likely to result in:

(1) An annual effect on the economy of $100 million or more;

(2) A major increase in costs or prices for consumers, individual industries, Federal, State or local government agencies, or geographic regions; or

(3) Significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States—based industries to compete with foreign-based enterprises in domestic or export markets.

After conducting a review of the expected effects of today's proposed rule, DOE finds that due to the nature of the coal market, competition in the coal industry, and the mineability of Federal tracts, the annual effect of the proposed rule is expected to be less than $100 million and the net effect of the proposed rule is expected to be positive. Therefore, DOE has determined that this proposed rule does not constitute a major rule and no Regulatory Impact Analysis will be prepared.

VIII. Compliance With the Regulatory Flexibility Act

The Regulatory Flexibility Act (Pub. L. 96-354, 94 Stat. 1164, 5 U.S.C. 601 *et seq.*) requires Federal agencies to consider the impact of proposed regulations on small businesses, small governmental units, and other small entities; to consider the ability of small entities to comply with the proposed regulation; and to consider less stringent alternative compliance standards for small entities. An agency is required to prepare a regulatory flexibility analysis to document its consideration of these factors except in the situation where the agency determines that a regulation will not have a significant economic impact on a substantial number of small entities. DOE certifies that, for the reasons discussed below, the promulgation of this regulation will not have a significant economic impact on a substantial number of small entities. Therefore, a regulatory flexibility analysis will not be prepared.

Few, if any, small entities will be affected by this rule change, and the impacts that could occur will be minor and beneficial to small entities. A current study of Federal coal leases by the Office of Technology Assessment (OTA) supports the following conclusions.

During the past ten years, there has been a drastic drop in the number of Federal leases held by small companies and unincorporated individuals resulting in a potentially adverse effect on competition. Generally, this has been the result of the high cost of developing coal mines. Since many small companies cannot make the necessary investment, they either sell or drop the lease, acquire partners to develop the lease, or are acquired by a larger corporation. The remaining leases held by small companies should follow the same pattern under both the current and proposed diligence rules. Many of these leases have been mined out or have small coal reserves that are expensive to develop. These leases will be relinquished. The economical leases will be sold and/or developed in time to meet diligence requirements.

The proposed diligence rule lengthens the time period certain lessees have to develop a lease. The economic effect of this change is expected to be beneficial because these leases would be developed according to a schedule which is more likely to maximize the net present value of the lease and hence government revenue from royalties. Both small and large lessees would benefit by this change. The only other small entities that may be affected are the municipalities in the areas of these leases. Since development of the few leases affected could be delayed several years, this could enable the associated jurisdictions better to plan for this development. Because the development plan for these leases should not change except for the timing, costs to these jurisdictions should not be altered significantly.

The following results are expected to occur:

(1) Few, if any, small entities will be affected by the proposed diligence rules;

(2) Any effects that do occur will be insignificant; and

(3) Any effects that occur will be beneficial.

Therefore, DOE has determined that there is no need for a Regulatory Flexibility Analysis of this proposed coal diligence rule.

(Mineral Lands Leasing Act, Act of February 25, 1920, ch. 85, 41 Stat. 437 (30 U.S.C. 181 *et seq.*), amended by Federal Coal Leasing Amendments Act of 1975, Pub. L. 94-377, 90 Stat. 1083; Mineral Leasing Act for Acquired Lands, Act of August 7, 1947, ch. 513, 613 Stat. 913 (30 U.S.C. 351 *et seq.*); Department of Energy Organization Act, Pub. L. 95-91, 91 Stat. 565 (42 U.S.C. 7101 *et seq.*), E.O. 12009, 42 FR 46267)

In consideration of the foregoing, it is proposed to amend Chapter II of Title 10, Code of Federal Regulations, as set forth below.

Issued in Washington, D.C., December 15, 1981.

Jan W. Mares,

Assistant Secretary for Fossil Energy.

PART 378—COAL LEASING

§ 378.102 [Amended]

1. Part 378 of Chapter II of Title 10, Code of Federal Regulations, is amended by deleting the definition of "Logical Mining Unit" in § 378.102 and adding a new definition of "Logical Mining Unit" to § 378.002 in alphabetical order to read as follows:

§ 378.002 Definitions.

* * * * *

"Logical Mining Unit" or "LMU" means an area of land designated by DOI in which the coal resources can be developed in an efficient, economical, and orderly manner as a unit with due regard to conservation of coal reserves and other resources. A logical mining unit may consist of one or more Federal leases, and may include intervening or adjacent lands in which the United States does not own the coal resources, but all the lands in a logical mining unit must be under the effective control of a single operator, be able to be developed and operated as a single operation and be contiguous.

* * * * *

2. Chapter II of Title 10, Code of Federal Regulations, is amended by adding and reserving a new Subpart C and adding a new Subpart D to Part 378 to read as follows:

Subpart C [Reserved]

Subpart D—Diligence Requirements

Sec.

378.301 Purpose and scope.
378.302 Definitions.
378.303 Resource recovery and protection plans.
378.304 Requirement for diligent development and continued operation.
378.305 Termination or cancellation for failure to meet diligence requirements.
378.306 Extension or suspension of diligence requirements.
378.307 Payment of advance royalties in lieu of continued operation.
378.308 Crediting of production toward diligent development.
378.309 Special LMU rules.
378.310 Enforcement and appeals.

Authority: Act of February 25, 1920, ch. 85, secs. 2, 7, and 32, 41 Stat. 438, 439, and 450 (30

U.S.C. 201, 207, and 189) and sec. 39 as added by Act of February 9, 1933, ch. 45, 47 Stat.798, as amended by secs. 5, 6, and, 14, Pub. L. 94-377; Act of August 7, 1947, ch. 513, secs. 3 and 10, 61 Stat. 914 and 915 (30 U.S.C 352 and 359); secs. 302, 303, and 644, Pub. L. 95-91, 91 Stat. 578-579, 579-580, 599 (42 U.S.C. 7152, 7153, and 7254); E.O. 12009, 42 FR 46267.

Subpart C [Reserved]

Subpart D—Diligence Requirements

§ 378.301 Purpose and scope.

(a) The purpose of the regulations in this Subpart D is to establish the diligence requirements which are applicable to all Federal coal leases and LMU's, including existing leases or LMU's. The regulations in this Subpart D do not apply to coal leases on Indian lands.

(b) The provisions in this Subpart D for diligent development and continued operation apply to all coal leases issued before August 4, 1976, that have not been readjusted between August 4, 1976, and the effective date of this Subpart D, during the period of time between the effective date of this Subpart D and the effective date of the next lease readjustment, unless the lessee elects to be governed by the clause in the lease which describes the minimum production requirement until such lease readjustment. Any lessee who elects to be subject to those lease terms until readjustment, as provided in this paragraph, shall notify DOI in writing within one year of the effective date of this Subpart D.

(c) Any Federal coal lease included in an LMU, including a lease for which the lessee has elected to be governed by the minimum production clause of the lease as provided by paragraph (b) of this section, shall be subject to the diligence requirements imposed on the LMU by this Subpart D in lieu of those diligence requirements of this Subpart D which would apply to the lease individually.

§ 378.302 Definitions.

For the purposes of this Subpart D:

"Advance Royalties" means a payment under a lease or LMU in advance of actual production and authorized by DOI to be made in lieu of continued operation. Payments made under the minimum production clause of a lease in lieu of actual production are not advance royalties for the purpose of § 378.307.

"Coal Reserves" means the tons of coal that can be mined commercially under existing technology and economics. Except as provided in § 378.309(b), coal reserves shall be those estimated by DOI as of the date of the initial mining plan or resource recovery and protection plan approval.

"Commercial Quantities" means one percent of the coal reserves or LMU coal reserves.

"Continued Operation" means the production of not less than commercial quantities of coal in each of the first two continued operation years following the achievement of diligent development and an average amount of not less than commercial quantities of coal per continued operation year thereafter, computed on a three-year basis consisting of the continued operation year in question and the two preceding continued operation years.

"Continued Operation Year" means the 12-month period beginning with the commencement of the first royalty reporting period following the achievement of diligent development, and each 12-month perod thereafter.

"Diligent Development" means the production of coal in commercial quantities prior to the end of the diligent development period.

"Diligent Development Period" means a period which shall begin on either:

(1) The effective date of the lease for all leases issued on or after August 4, 1976;

(2) The effective date of the first lease readjustment after August 4, 1976, for all leases issued prior to August 4, 1976, and readjusted after that date; or

(3) For all LMU's, the most recent of the dates established under paragraph (1) or (2) of this definition for each Federal lease included in the LMU and occurring prior to the time of LMU approval, unles the LMU contains a lease issued prior to August 4, 1976, that has not been readjusted between August 4, 1976, and the date of LMU approval, in which case the diligent development period for the LMU shall begin on the date of approval of the LMU; and

which shall terminate upon the production of coal in commercial quantities or at the end of ten years, whichever occurs first, unless the period is extended as provided in § 378.306.

"Lessee" means a person authorized by a Federal coal lease or an approved LMU or an approved assignment thereof, to develop and produce coal, including all parties holding such authority by or through the lessee and the person designated to conduct operations.

"LMU Coal Reserves" means the sum of estimated Federal and non-Federal coal reserves in the LMU. Except as provided for in § 378.309(b), the LMU coal reserves are those estimated by DOI as of the date of the initial resource recovery and protection plan approval.

"Royalty Reporting Period" means the period of time established by DOI for calculation of production royalties due.

§ 378.303 Resource recovery and protection plans.

(a) A resource recovery and protection plan shall be submitted for every lease no later than three years after the effective date of the lease for leases issued on or after August 4, 1976, or the effective date of the first lease readjustment after August 4, 1976, for leases issued prior to August 4, 1976, unless a current mining plan or resource recovery and protection plan has previously been submitted and contains the information required by 30 CFR Part 211.

(b) A resource recovery and protection plan shall be submitted for each LMU no later than three years after the effective date of LMU approval, and it shall cover all Federal and non-Federal lands within the LMU and contain the information required by 30 CFR Part 211.

(c) Each resource recovery and protection plan approved for an LMU shall provide for the mining of all LMU coal reserves not later than 40 years after the date of first production from the LMU after LMU approval. Any revised or amended resource recovery and protection plan shall provide for the mining of all LMU coal reserves not later than the end of the original 40-year period.

§ 378.304 Requirement for diligent development and continued operation.

(a) Each Federal coal lease and LMU is required to achieve diligent development.

(b) Once a Federal lease or LMU has achieved diligent development, the lease or LMU shall be maintained in continued operation every continued operation year thereafter, except as provided in § 378.306 (b) or (d).

§ 378.305 Termination or cancellation for failure to meet diligence requirements.

(a) Any Federal coal lease or LMU which has not achieved diligent development shall be terminated by DOI.

(b) Any Federal coal lease included in an LMU which has been terminated under the provisions of paragraph (a) of this section shall then be subject to the diligence requirements that would have been imposed on that lease by this Subpart D if the lease had not been included in the LMU.

(c) DOI may cancel any Federal coal lease or LMU which fails to meet either the requirement for submission of a resource recovery and protection plan

contained in § 378.303, or the requirement for continued operation contained in § 378.304.

§ 378.306 Extension or suspension of diligence requirements.

(a) Upon timely notification by the lessee to DOI, the diligent development period shall be extended by the period of time in which DOI determines that operations under the Federal coal lease or LMU are interrupted by strikes, the elements, or casualties not attributable to the lessee.

(b) Upon timely notification by the lessee to DOI, the requirement for continued operation contained in § 378.304(b) shall be suspended by the period of time in which DOI determines that operations under the Federal coal lease or LMU are interrupted by strikes, the elements, or casualties not attributable to the lessee.

(c) Upon timely notification by the lessee to DOI, the date by which a lessee is required by § 378.303 to submit a resource recovery and protection plan may be extended if DOI determines that operations under the Federal coal lease or LMU are interrupted by strikes, the elements, or casualties not attributable to the lessee.

(d) Upon request of the lessee, DOI may suspend the requirement for continued operation upon payment of advance royalties in accordance with § 378.307 for any continued operation year in which the lessee does not expect to meet the requirement for continued operation, if DOI determines it to be in the public interest. DOI may, upon six months notification to the lessee, cease to accept advance royalties in lieu of the requirement for continued operation.

(e) DOI, in the interest of conservation, may direct the suspension of operations and production under any Federal coal lease or LMU. If operations are so suspended, then DOI may extend the date by which the lessee is required by § 378.303 to submit a resource recovery and protection plan. The diligent development period shall be extended or the requirement for continued operation suspended, as applicable, for the period of such suspension. Nothing in this paragraph shall be construed as granting to DOI the authority to waive, suspend, or reduce advance royalties.

§ 378.307 Payment of advance royalties in lieu of continued operation.

(a) Advance royalties may only be accepted in lieu of continued operation as provided for in § 378.306(d) and only upon application to and approval by DOI.

(b) Any request by a lessee for suspension of the contined operation requirement under § 378.306(d) shall be made no later than 30 days after the beginning of the continued operation year. If a lessee requests authorization to pay advance royalties in lieu of continued operation later than 30 days after the beginning of any continued operation year, DOI may condition acceptance of advance royalties on the payment of interest on the amount of the advance royalties due. The interest will be calculated from the beginning of the continued operation year until the date of the request.

(c) When advance royalties are accepted in lieu of continued operation under this section, they shall be paid in an amount equivalent to the production royalty that would be owed on the production of one percent of the coal reserves or LMU coal reserves. For purposes of this paragraph, the production royalty rate for an LMU shall be deemed to be 8 percent for LMU coal reserves that would be recovered by underground mining operations, and 12½ percent for LMU coal reserves that would be recovered by other mining operations. In the event that an LMU contains both underground and other mining operations, a 12½ percent royalty rate shall be used when calculating any advance royalty owed. The unit value of the coal for determining the advance royalty payment for a lease or LMU shall be either: (1) The unit value for production royalty purposes of coal produced and sold under the Federal coal lease or LMU during the immediately preceding production royalty payment period; or (2) if no coal was produced and sold under the Federal coal lease or LMU during the immediately preceding royalty payment period, or if DOI finds that there is an insufficient number of such sales to determine such value equitably, computed at the average unit price at which coal from other Federal leases in the same region was sold during such period; or (3) if there were no sales of Federal coal from such region during such period or if DOI finds that there is an insufficient number of such sales to determine such value equitably, determined by DOI.

(d) The aggregate number of years during the period of any Federal coal lease or LMU for which advance royalties may be accepted in lieu of the requirement of continued operation shall not exceed ten. For leases issued prior to August 4, 1976, advance royalties shall not be accepted in lieu of continued operation for more than a total of 10 years following the first lease readjustment after August 4, 1976. Any continued operation year in which any advance royalty is accepted shall be deemed a year in which advance royalties are accepted in lieu of continued operation for purposes of this paragraph. However, if a lessee meets the requirement for continued operation in any continued operation year in which the lessee has paid advance royalties, such year shall not be considered when calculating the maximum number of years for which advance royalties may be accepted for the lease or LMU. The number of years for which advance royalties are paid under any Federal coal lease prior to its inclusion in an LMU shall not be considered when calculating the maximum number of years for which advance royalties may be accepted for the LMU.

(e) The dollar amount of any production royalty for a Federal coal lease or LMU owed for any year during or subsequent to the year in which advance royalties are paid, shall be reduced (but not below zero) by the dollar amount of any advance royalty paid under that lease or LMU to the extent that such advance royalties have not been used to reduce production royalties for a prior year. Advance royalties paid on an LMU may be credited at the lessee's election against production royalties owed for any Federal lease or leases in the LMU.

(f) No advance royalty paid during the initial twenty-year term of a Federal coal lease or LMU shall be used to reduce a production royalty under paragraph (e) of this section after the twentieth year of a lease or LMU. For purposes of this paragraph, the initial twenty-year term of a lease shall commence on the effective date of the lease for all leases issued on or after August 4, 1976; on the effective date of the first lease readjustment after August 4, 1976, for all leases issued prior to August 4, 1976; and on the effective date of LMU approval for all LMU's. Any advance royalty paid on a lease prior to its inclusion in an LMU shall be credited to the LMU and shall be considered to have been paid on the date of LMU approval for the purposes of this paragraph, provided that the lease has been included in an LMU within the initial twenty-year term of the lease as determined in this paragraph and to the extent that the advance royalties have not been used to reduce production royalties on the lease.

§ 378.308 Crediting of production toward diligent development.

(a) For Federal coal leases issued or readjusted on or after August 4, 1976, all

production after the effective date of the lease or lease readjustment shall be credited toward diligent development.

(b) For Federal coal leases issued before August 4, 1976, that are governed by the diligent development and continued operation requirements of this Subpart D because the lessee did not make the election provided for in § 378.301(b), all production after August 4, 1976, and prior to the effective date of this Subpart D shall be applied toward diligent development, unless the lessee elects not to have this production credited. Any lessee who elects not to have this production applied toward diligent development must notify DOI within one year of the effective date of this Subpart D. If the pre-August 4, 1976 lease was readjusted after August 4, 1976, but before the effective date of this Subpart D, the lessee may only elect not to credit production prior to the readjustment. Any production after the readjustment shall be applied toward diligent development pursuant to paragraph (a) of this section.

(c) For Federal coal leases issued before August 4, 1976, that have not been readjusted between August 4, 1976 and the effective date of this Subpart D, and that are governed by the diligent development and continued operation requirements of this Subpart D because the lessee did not make the election provided for in § 378.301(b), all production after the effective date of this Subpart D shall be applied toward diligent development.

(d) For Federal coal leases issued before August 4, 1976, that are, by the lessee's election under § 378.301(b), governed by their lease clause which describes the minimum production requirements until the first lease readjustment after August 4, 1976, no production prior to the effective date of that first lease readjustment shall be applied toward diligent development.

(e) For LMU's, any production credited under this Subpart D to a Federal lease prior to its inclusion in the LMU shall be applied toward diligent development for the LMU.

§ 378.309 Special LMU rules.

(a) Production anywhere within the LMU after the date of LMU approval, of either Federal or non-Federal coal or a combination thereof, shall be applied toward satisfaction of the requirements of this Subpart D for achievement of diligent development and continued operation for the LMU.

(b) If an approved LMU is enlarged or diminished by DOI, the coal reserves and LMU coal reserves shall be adjusted by DOI accordingly. The dates for submission of a resource recovery and protection plan and achievement of diligent development shall not be changed by any such enlargement or diminution of the LMU.

§ 378.310 Enforcement and appeals.

The provisions of this Subpart D, including the enforcement of these provisions and appeals from determinations made in accordance with these provisions, shall be administered by DOI as prescribed in 30 CFR Part 211 and Part 290, and 43 CFR Part 4, as appropriate.

[FR Doc. 81-36434 Filed 12-21-81; 8:45 am]
BILLING CODE 4450-01-M

SUBMITTED BY INDUSTRY

Legislative History of Section 3 of the Federal Coal Leasing Amendments Act (FCLAA) of 1976

Congress intended section 3 of the FCLAA to address what was perceived to be one of several "deficiencies" in the Mineral Leasing Act of 1920, that is, the two-fold problem of speculative holding and non-production of federal coal leases. House Report No. 94-681 suggested that federal coal leases were effective "virtually forever"[1] because no action had ever been taken by the Department of the Interior to cancel a lease for failure to comply with the condition of diligent development.[2] Testimony received by the House Interior Subcommittee on Mines and Mining indicated that only 59 of 533 existing (pre-1976) leases were producing coal, the remainder being held under a waiver of the condition of continued operation.

In conjunction with non-development of existing leases, House Report No. 94-681 stated that the process of issuing leases on a preference right basis "contributed heavily to speculative holding of leases by making it possible to gain control of public resources at virtually no cost."[3] Section 2(b) of the 1920 Act provided:

> Where prospecting or exploratory work is necessary to determine the existence or workability of coal deposits in any unclaimed, undeveloped area, the Secretary of the Interior may issue, to applicants qualified under this chapter, prospecting permits for a term of two years...and if within said periods of two years thereafter the permittee shows to the Secretary that the land contains coal in commercial quantities, the permittee shall be entitled to a lease under this chapter for all or part of the land in his permit.[4]

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[1] H. Rep. No. 94-681, 94th Cong., 1st Sess. 14.

[2] Section 7 of the 1920 Act provided, in pertinent part, that coal leases "shall be for indeterminate periods upon condition of diligent development and continued operation of the mine or mines." 30 U.S.C. 207 (1970).

[3] H. Rep. No. 94-681, 94th Cong., 1st Sess. 15.

[4] 30 U.S.C. 201(b) (1970).

This provision vested a preference right to a lease, to be issued non-competitively, to prospecting permittees who could demonstrate discovery of commercial quantities of coal in compliance with section 2(b). It was alleged in House Report 94-681 that 45 percent of all federal coal leases were issued under this method, and that energy "speculators" entered the coal market in large numbers because of this provision in the 1920 Act.[5]

The 1976 leasing amendments directly addressed speculation and non-production in three principal ways. First, section 4 terminated preference right leasing, subject to valid existing rights.[6] Second, section 6 eliminated the indeterminate nature of federal coal leases and provided the following:

> A coal lease shall be for a term of twenty years and for so long thereafter as coal is produced annually in commercial quantities. Any lease which is not producing in commercial quantities at the end of ten years shall be terminated.[7] (Emphasis added).

And finally, section 3 of the FCLAA added a provision to section 2 of the 1920 Act which declared the following:

> The Secretary shall not issue a lease or leases under the terms of this Act to any person, association, corporation, or any subsidiary, affiliate, or persons controlled by or under common control with such person, association, or corporation, where any such entity holds a lease or leases issued by the United States to coal deposits and has held such lease or leases for a period of ten years when such entity is not, except as provided for in section 7(b) of this Act, producing coal from the lease deposits in commercial quantities. In computing the ten-year period referred to in the preceding sentence, periods of time prior to the date of enactment of the Federal Coal Leasing Amendments Act of 1975 shall not be counted.[8]

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[5] H. Rep. No. 94-681, 94th Cong., 1st Sess. 15.

[6] 30 U.S.C. §201 (note).

[7] 30 U.S.C. §207 (1976).

[8] 30 U.S.C. 201(a)(2)(A)(1976).

The section 3 provision poses two difficulties. First, it was intended to be drafted in such a manner as to apply to leases in effect at the date of enactment of the Act, but before those leases were subject to readjustment. Section 3 of the FCLAA is the only provision which applies to pre-1976 leases before readjustment.[9]

Congress was cognizant of potential constitutional questions which could be raised by the retroactive application of new production requirements to pre-1976 leases when it contemplated a means to encourage production on those leases. Congresswoman Patsy Mink, the then chairperson of the Mines and Mining Subcommittee of the House Interior Committee and floor manager of H.R. 6721, the bill which ultimately was enacted, made particular reference to this aspect of the bill during floor debate. Said Mink, "Nor do we wish to trigger sticky constitutional questions involving the taking of legislatively conferred rights by reacting to the deficiencies of the current law with retroactive application of tough new lease standards and terms to lessees who legally gained their rights relying on the provisions of current law."[10] Mrs. Mink explained the applicability of the FCLAA to existing and prospectively issued leases in the following manner:

> The 533 existing Federal leases would be unaffected by the bill except to the extent its provisions are made applicable upon the periodic ten year readjustment of lease terms, or upon the inclusion of an existing lease in a logical mining unit. The only other sanction imposed on existing leases would be a prohibition on leasing any additional Federal tracts to an entity which holds a non-productive lease 15 years[11] after the date of enactment of this bill.[12] (Emphasis added).

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[9] "Congress intended that the FCLAA not affect pre-FCLAA leases before those leases become subject to readjustment, with one exception--section 3 of the FCLAA...". Solicitor's Opinion M36939, September 17, 1981; Memorandum to Assistant Secretaries, Land and Water Resources and Energy and Minerals, "Whether leases issued prior to August 4, 1976 subject to readjustment after that date must be readjusted to conform to the Federal Coal Leasing Amendments Act of 1976," at 5.

[10] 122 Cong. Rec. H 134 (daily ed. January 21, 1976).

[11] The 15-year period referenced in section 3, as well as the 15-year periods of section 6, were reduced to 10 years by an amendment offered on the floor the day of House passage of H.R. 6721 by Rep. Ken Hechler of West Virginia.

[12] 122 Cong. Rec. H135 (daily ed. January 21, 1976).

Thus, it is clear that Congress intended to reach pre-1976 leases upon readjustment except with respect to the application of section 3. Pre-1976 leases would have to produce in commercial quantities by August 4, 1986, or the lessee would be barred from acquiring "any additional Federal tracts." Interpretation of the phrase "any additional Federal tracts" is the second problematic aspect of section 3 and will be discussed immediately below.

Since enactment of the FCLAA there has been considerable discussion as to whether the section 3 proscription applies to the issuance of any additional coal leases, or any additional mineral leases obtainable under the Mineral Leasing Act of 1920. Interpretation of the provision is critical because it could mean that a coal lessee cannot acquire any mineral leases issued under the 1920 Act--those for oil, gas, oil shale, phosphate, potassium, sodium, native asphalt, solid and semisolid bitumen, and bituminous rock, in addition to coal--if he is not producing a single pre-1976 coal lease by August 4, 1986. While there is not an abundance of legislative history on section 3, it does appear that Congress intended that section 3 bar the issuance of additional mineral leases of every type. Moreover, there is some evidence that Congress intended section 3 to be an even stronger incentive to produce coal from pre-1976 leases than the inducement contained in current law.

The Department of the Interior protested the onerous nature of a different version of section 3 in H.R. 6721 in 1975 which brought some acquiescence by the House of Representatives. The version of H.R. 6721 which was reported out of the Mines and Mining Subcommittee on May 22, 1975, contained a provision which stated:

> No person, association, corporation, or any subsidiary, affiliate, or persons controlled by such person, association, or corporation shall take, hold, own or control any lease issued by the Secretary under the terms of this Act, nor shall the Secretary issue a lease or leases to any such person, association, or corporation where any such entity holds a lease or leases issued by the United States to coal deposits and has held such lease or leases for a period of ten or more years when such entity is not, except as provided for in section 7(b) of this Act, producing coal from the lease deposits in commercial quantities.[13] (Emphasis added).

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[13] Section 3 of H.R. 6721, 94th Cong., 1st. Sess. (May 16, 1975).

This provision meant that any entity in violation of section 3 would not only have its coal lease cancelled, but all its other mineral leases cancelled as well. Interior's Assistant Secretary, Jack Horton, objected to this provision in the following manner:

> It should also be noted that the penalty for not producing within 10 years[14] would not only be cancellation of the lease, but cancellation of any other lease issued under the Mineral Leasing Act that the person, association, or corporation holds. We recommend that this unusually onerous subsection be deleted from the bill.[15] (Emphasis added)

The House relented on this provision, but the legislative history indicates that Congress fully intended section 3 to prohibit the Secretary from issuing any type of mineral lease to entities in violation of section 3. Mrs. Mink explained the applicability of the FCLAA as follows:

> The 533 existing Federal leases would be unaffected by the bill except to the extent its provisions are made applicable upon the periodic ten year readjustment of lease terms, or upon the inclusion of an existing lease in a logical mining unit. The only other sanction imposed on existing leases would be a prohibition on leasing any additional Federal tracts to an entity which holds a non-productive lease 15 years[16] after the date of enactment of this bill.[17] (Emphasis added).

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14 The May 6, 1975, version of H.R. 6721 established the time period in section 3 for the achievement of commercial production at 10 years. When the bill reached the full House Interior Committee, however, it provided for a fifteen-year period. An amendment on the floor of the House on the day of House passage finally set the period at ten years. See, 122 CONG. REC. H149 (daily ed., January 21, 1976).

15 H. Rep. No. 94-681, 94th Cong., 1st Sess. 38.

16 See footnotes 11 and 14, supra.

17 122 CONG. REC. H135 (daily ed., January 26, 1976).

The section-by-section analysis of House Report 94-681 simply stated the following with respect to section 3:

> This amendment would bar the issuance of new leases to any individual or corporations that have held a lease for a period of 15 years,[18] beginning on the date of enactment of the Federal Coal Leasing Amendments Act of 1975,[19] without producing coal therefrom. (Emphasis added).[20]

Moreover, House Report 94-681 explained treatment of the speculation problem in H.R. 6721 in this respect:

> The problems of speculation are addressed directly by H.R. 6721, which requires termination of any lease which is not producing in commercial quantities at the end of 15 years. Old leases (those existing on the date of enactment of the 1975 Act) would be exempt from this provision, except to the extent it might be made applicable upon readjustment of lease terms, but the lessees would be prohibited from acquiring any new Federal leases should they continue to hold old leases 15 years after enactment without producing therefrom.[21] (Emphasis added).

Further, Congressman Drinan said that, "Leases in existence would be exempt from this (10-year diligent development) provision (in section 6), but the lessees could not acquire any new leases while they continue to hold non-producing tracts."[22] (Emphasis added). And finally, two memoranda from the office of the Solicitor of the Department of the Interior lend credence to this view. A March 25, 1980, memorandum to the Assistant Solicitor, Onshore Minerals, concluded that, "the penalty for violating section 3 is to bar a lessee from acquiring any of the various types of mineral leases obtainable under the Mineral Leasing Act."[23] (Emphasis added).

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[18] See footnotes 11 and 14, supra.

[19] Section 8 of the Act of October 30, 1978, changed the title of the Federal Coal Leasing Amendments Act of 1975 to the Federal Coal Leasing Amendments Act of 1976. Pub. L. No. 95-554, 92 Stat. 2075.

[20] H. Rep. No. 94-681, 94th Cong., 1st. Sess. 22.

[21] H. Rep. No. 94-681, 94th Cong., 1st. Sess. 15.

[22] 122 CONG. REC. H143 (daily ed., January 21, 1976).

[23] Memorandum to Assistant Solicitor, Onshore Minerals, March 25, 1980, "Section 3 of the FCLAA," at 1.

Solicitor William H. Coldiron concluded that "a lessee who holds a non-producing lease, including pre-FCLAA leases, for ten years after enactment of the FCLAA may not be issued new federal leases."[24]

Thus, a fair reading of the legislative history and a literal reading of the statute suggest that the provision was intended to prohibit the issuance of all types of mineral leases, and not just coal leases, to entities who hold unproductive federal coal leases for ten years.

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24 Solicitor's Opinion M-36939, September 17, 1981; Memorandum to Assistant Secretaries, Land and Water Resources and Energy and Minerals, "Whether leases issued prior to August 4, 1976 subject to readjustment after that date must be readjusted to conform to the Federal Coal Leasing Amendments Act of 1976," at 5.

BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Secretary Of The Interior

Cooperative Leasing Offers Increased Competition, Revenues, And Production From Federal Coal Leases In Western Checkerboard Lands

The Secretary of the Interior will soon decide whether to adopt the cooperative coal leasing concept and use it to conduct the Department's proposed Federal lease sale of the Red Rim tract in Wyoming.

Because of the potential to significantly increase competition, lease sale revenues, and production, GAO believes the Department should plan and conduct cooperative lease sales, including the proposed sale of Red Rim. The data from Red Rim, together with data from future cooperative lease sales, will provide a sound foundation needed for an intelligent decision on the continued use of the concept.

GAO makes recommendations leading to the cooperative leasing of Red Rim and continued application of the concept.

EMD-82-72
APRIL 28, 1982

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

RGY AND MINERALS
DIVISION

B-205879

The Honorable James G. Watt
Secretary of the Interior

Dear Mr. Secretary:

This report summarizes our evaluation of the Department of the Interior's ongoing experiment with cooperative leasing agreements as a possible alternative approach for developing Federal coal in Western "checkerboard lands." 1/ As you know, the cooperative coal leasing concept combines--before the actual lease sale--the surface and coal rights to checkerboard lands into a single logical mining unit. We understand a Secretarial Issue Document on cooperative leasing and the first cooperative lease sale will soon be forwarded for your decision. Because of the potential to significantly increase competition, revenues, and production from Federal leases, we believe that Interior's efforts to plan and conduct cooperative lease sales, including the proposed Red Rim sale, should be continued.

The Department chose the Red Rim, Wyoming, tract as the test site for the first cooperative coal lease sale. However, obtaining consent from the private surface owner, and unresolved legal issues surrounding participation by the mining affiliates of land grant railroads, complicate the proposed sale. Moreover, the possibility of protracted litigation of either issue may persuade the Department to withdraw the tract from consideration for sale under the cooperative agreement concept. We are concerned that this first experience might jeopardize the concept in the future. And, we believe it would be imprudent to decide on the merits of the cooperative coal leasing concept based solely on the outcome of Red Rim.

Cooperative coal leasing could substantially increase competition, revenues, and production from checkerboard area coal leases. In addition, the concept could lead to mining of Federal coal that might not otherwise be recovered. However, before meaningful comparisons can be made against other leasing alternatives--such as normal leasing procedures, lease and land exchanges, and eminent domain condemnation--more experience with the concept is needed. In obtaining this experience, we believe that the public--particularly the coal industry and private surface owners--should play stronger roles. Greater public participation

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1/Alternating tracts of federally and privately owned land.

could help ensure that future cooperative coal leasing agreements are made voluntarily in a manner consistent with the concept's underlying theoretical basis. On page 13, we make recommendations leading to continued application of the cooperative leasing concept.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our basic objective was to determine whether Interior's efforts to plan and conduct a cooperative coal lease sale would result in a fair and reasonable first test for the concept. To satisfy this basic objective, we employed a case study methodology limited to an analysis of the events leading to the proposed April 1982 cooperative sale of the Red Rim tract in the Green River/ Hams Fork Federal Coal Region in northwest Colorado and southwest Wyoming. However, because our approach to this evaluation was tempered with the understanding that the Red Rim experiment was the Department's first experience with this concept, the results of our work should be seen in light of this important qualification.

In forming the technical foundation for this evaluation, we relied on Department of Justice reports covering competition in the coal industry 1/ and selected contractor reports. 2/ We also considered the results of Interior's studies targeted at identifying and solving fair market value problems. The cooperative leasing concept is anchored in these studies.

We analyzed the design of the proposed cooperative leasing experiment and reviewed public comments on Interior's announcements in the December 30, 1980, and November 18, 1981, Federal Register. We interviewed selected Federal officials at the Department of the Interior and Bureau of Land Management (BLM) offices in Washington, D.C.; the Bureau's State offices in Cheyenne, Wyoming, and Billings, Montana; and the Bureau's district office in Rawlins, Wyoming. We also contacted representatives of the Rocky Mountain Energy Company in Broomfield, Colorado.

1/U.S. Department of Justice, "Competition in the Coal Industry," Report of the U.S. Department of Justice Pursuant to Section 8 of the Federal Coal Leasing Amendments Act of 1976, May 1978 and Nov. 1980, respectively.

2/Science Application Inc., "Enhancing Competition for Federal Coal Leases," Jan. 1976, SAI-76-513-WA; and Environmental Law Institute, "Management of Federal Coal Properties in Areas of Fragmented Ownership," Jan. 3, 1980, Contract No. 14-01-0001-78-C-19.

This evaluation was conducted in accordance with the Comptroller General's "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions."

BACKGROUND

Beginning in 1850, the Congress granted land to many railroads for the purpose of encouraging development of the West. The grants generally consisted of 200- to 400-foot rights-of-way for trackage, and alternating (square mile) sections of land on either side of the right-of-way ranging from 6 to 20 miles. A total of 89 grants were made, but 17 were later forfeited due to lack of performance. Under the remaining 72 grants, more than 131 million acres of land were actually transferred to the railroads. The grants created three corridors through Western States with land ownership patterns appearing like checkerboards--the railroads and the Federal Government owning alternating sections. Although some of the grants excluded mineral rights, coal and iron were not excluded, and therefore, the railroads initially owned both surface and coal rights in the checkerboard areas.

Over the years, some railroads merged with others or were sold. Currently, the checkerboard areas in the major coal regions are adjacent to the Burlington Northern Railroad, through North Dakota and Montana; the Union Pacific Railroad, through Colorado, Wyoming, and Utah; and the Santa Fe Railroad, through New Mexico and Arizona. As a group, the companies which own these three railroads are reported to own about 15 billion tons of coal reserves, which is roughly equal to the Federal reserves in the checkerboard areas.

Over time, the railroads and the Federal Government sold some of the surface rights in the checkerboard areas. As a result, checkerboard coal development is complicated not only because of multiple coal owners, but also by the existence of split estates, where one party owns the coal while another owns the surface rights. The checkerboard ownership pattern and the occurrence of split estates complicate Federal coal leasing efforts, increase mining costs, and serve to reduce competitive interest in checkerboard area leases.

Because individually owned checkerboard tracts are generally too small to mine efficiently as a single unit, mining companies must obtain two or more adjacent tracts, as well as consent from the surface owner(s), in order to form a logical mining unit. The additional cost of forming a logical mining unit creates market imperfections which drive down the value of individual tracts--both Federal and private. If these tracts were combined, however, the

Department believes the value of the combined tract would exceed considerably the sum of the values of the individual tracts. In theory, cooperative leasing is one mechanism for combining the individual tracts before a lease sale, thus enhancing their value to potential bidders and the resulting revenues to the Government.

DESIGNING A WORKABLE FEDERAL/PRIVATE COOPERATIVE COAL LEASING EXPERIMENT

About 3 years ago, the Department began an experiment aimed at conducting a cooperative coal lease sale and through post-sale evaluations, determining the feasibility of making cooperative leasing a viable alternative to more conventional leasing methods. BLM's Wyoming State Director recommended the Red Rim tract. It is considered to be in a prime coal producing area and close to transportation.

The former Conservation Division of the U.S. Geological Survey (USGS) performed an economic recovery potential analysis for the proposed combined tract in September 1979. According to that analysis, the tract's total surface is 20,480 acres, of which 10,320 acres are federally owned and 10,160 acres are privately owned. A tract of this size would be among the largest ever leased by the Federal Government. An estimated 85 percent of the underlying coal, about 50 million tons, is believed recoverable.

The design of the cooperative leasing experiment at Red Rim was the product of a June 1980 task force consisting of representatives from the Interior's Office of Policy Analysis; Office of Coal Leasing, Planning and Coordination; Office of the Solicitor; BLM; and USGS.

A December 30, 1980, Federal Register announcement explains that in designing a workable cooperative leasing experiment, the task force established the following basic criteria:

--The proposal must provide for pre-sale packaging of Federal and private coal.

--Any lease terms affecting the value of the lease must be the same in both public (Federal) and private leases.

--Due to the absence of legal authority for compulsory pre-sale packaging of Federal and private tracts, the Department must rely upon voluntary participation from private parties.

--The proposal must be in accord with all current laws and regulations governing Federal coal leasing.

A potential additional criterion would have provided that the private coal owner not participate in the sale as a bidder. This criterion was subsequently rejected by the task force as a result of negotiations with the private coal owner--Rocky Mountain Energy Company, a subsidiary of the Union Pacific Corporation and an affiliate of the Union Pacific Railroad.

Within these criteria, the task force proposed a presale cooperative leasing agreement providing an opportunity for interested private parties to obtain separate leases for both Federal and private coal necessary for an efficient mining operation. The Federal coal lease sale would be conducted under normal procedures--sealed bids followed by an oral auction. But under the conditions set forth in the pre-sale cooperative agreement the winning bidder for the Federal coal would be given the opportunity to buy the private coal and have 45 days to conclude a sale agreement and satisfy other Federal requirements.

The price of the private coal would be a function of the cost of the Federal lease and determined by applying a Federal/private bid ratio announced before the Federal lease sale. According to the Department, it would be a fixed ratio based on economic evaluations of the tracts and arrived at through bilateral negotiation. It would also be used to set a mutually acceptable minimum bid for each lease. Royalties would be apportioned according to the relative values of the Federal and private coal.

Interior officials realize that the list of possible questions on the mechanics of cooperative leasing is lengthy. They believe, however, that many questions can be answered by the experience gained from attempting to conduct a cooperative lease sale. Nonetheless, many concerns about Interior's proposed application of the concept were expressed through public comments on the planned cooperative leasing of the Red Rim tract.

A number of questions have surfaced about the need for cooperative leasing, its impact on competition in the coal industry, and who would benefit most from its implementation. Some of the concerns expressed in public comments have not been addressed formally through a revised cooperative agreement format.

PUBLIC COMMENTS ON THE
DEPARTMENT'S FEDERAL/PRIVATE
COOPERATIVE COAL LEASING PROPOSAL

The proposed cooperative lease sale at Red Rim has been troubled by a number of public concerns raised in comments responding to Interior's December 30, 1980, and November 18, 1981, Federal Register announcements. These concerns include the Federal Coal Regions in which it will be workable. Some

questioned the Government's statutory authority to impose such a program and others questioned whether the rights of private surface owners and private leaseholders, as well as existing Federal lessees, were given adequate consideration. Some asked if the mining company affiliates of land grant railroads would be allowed to participate as bidders when railroad coal is included in the combined tract. Others flatly objected to any participation by railroad mining affiliates. Concern over a potential National Environmental Policy Act compliance requirement was also raised. Although these concerns served to bring important issues to the Department's attention, most were anticipated beforehand and are unlikely to influence Interior's policy.

Although each of the public concerns could potentially lead to litigation, two are complicated, controversial matters that could result in the delay or possible cancellation of the proposed cooperative lease sale at Red Rim: concerns over the (1) rights of private surface owners and (2) unresolved legal issues surrounding participation by the mining affiliates of the land grant railroads. Whether these concerns relate chiefly to the cooperative leasing concept itself or only to the experiment at Red Rim has not been determined.

Interior officials believe the bulk of industry and public opposition is against the Red Rim experiment instead of the concept per se. These officials argue that under different circumstances--that is, with a more agreeable private surface owner and less bidding interest from the railroad mining affiliate--opposition to a cooperative lease sale similar to that at Red Rim would be substantially less. Both the private surface owner and the railroad mining affiliate issues are discussed in more detail below.

Difficulties obtaining consent from Red Rim private surface owners

Although the Federal Government owns the surface above its share of Red Rim coal, the owner of the private coal--Rocky Mountain Energy Company--does not own the surface over its coal. Private surface ownership is vested with individuals owning and operating cattle ranches. The single largest rancher owns roughly 90 percent of the surface over Red Rim's privately owned coal reserves and holds an agency agreement to represent the other ranchers.

According to Interior officials, Wyoming State law basically grants "resident or agricultural" surface owners veto power over surface coal mining. The attorney for the cattle ranchers contends

they were first approached by representatives of the Union Pacific Railroad (current affiliate with Rocky Mountain Energy Company) in 1976. 1/ At that time, efforts to either buy out the ranchers or arrive at an equity or royalty position were begun. According to Interior records, Rocky Mountain Energy negotiated with the cattle ranchers, but could not secure a consent agreement.

In an August 13, 1981, memo to BLM's Office of Coal Management, the Task Force on Cooperative Leasing recommended abandoning the experiment to lease Red Rim cooperatively. According to the memo, the overriding reason behind the recommendation was the inability to include private surface owner rights over the Rocky Mountain Energy coal in the proposed cooperative leasing agreement. The Task Force reasoned that a basic precept of the experiment has been that any terms affecting the value of the lease must be the same or comparable in both public and private leases. It concluded that, since the Federal lease on Red Rim will convey the right to enter and mine over the Federal surface (i.e., both surface and coal rights), the private lease should also.

The Task Force found that it would be possible to force the Red Rim cooperative sale further, but not without appearing to favor either Rocky Mountain Energy or the private surface owners and not without jeopardizing the public's interest in the coal. If the Red Rim sale was forced further, the Task Force felt cooperative leasing would lose its very important "voluntary" cast and continuation then would serve no purpose.

About 5 weeks later, the Task Force withdrew its earlier abandonment recommendation. This action resulted from an August 27, 1981, Rocky Mountain Energy proposal to compensate the eventual successful bidder on Red Rim an amount that the Task Force reported equitably represents the value of the private surface rights. Interior officials could not, however, provide us with detailed information explaining how they determined the equitable value of the private surface rights.

In a November 18, 1981, Federal Register announcement, the Department stated that

> "* * * RME (Rocky Mountain Energy) has offered to include a provision to the following effect in its lease with the successful bidder: If the Red Rim tract is leased in a cooperative lease sale, and the winning bidder for the

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1/U.S. Senate, Hearings Before the Senate Subcommittee on Energy and Mineral Resources, Committee on Energy and Natural Resources, on S. 1542, Sept. 11 and Oct. 1, 1981, pp. 170 to 193.

> combined lands is other than RME or one of the surface owners (or a party affiliated with a surface owner) RME would contribute by assignment up to a 3% coal production royalty on its land upon consummation of a 'surface owner agreement' with such owners in a form satisfactory to RME. RME would also be willing to contribute upon consummation of such an agreement or agreements up to $400,000 to be distributed rateably among such surface owners as an advance royalty to be recouped by RME out of the first monies payable to such owners on the coal production royalty assigned them by RME * * *."

The Department feels this offer is within the range of production royalties commonly offered private surface owners under similar situations and is a significant advance step that would not normally be negotiated until after the actual lease sale.

Establishing an advance royalty agreement, although it may attract a number of additional prospective bidders to the Red Rim sale, may not result in the essential private surface owner consent agreement. Interior officials are concerned that the unwilling private surface owners and Rocky Mountain Energy will end up in protracted litigation which will either delay or negate the the cooperative leasing of Red Rim. Unless an agreement can be reached, under Wyoming's untested statute, the mine operators are required to post a bond covering prospective damage to the surface owners' estates. The surface owners will be entitled to annual payments for damages to their land, crops, overall operations, and other property. Rocky Mountain Energy is expected to argue a reserved right to use as much of the surface estate as is necessary to develop the mineral (coal) estate without compensating the surface owners. Because Wyoming courts have not addressed such questions, the outcome is uncertain at best. However, Texas courts have examined the extent of surface owner rights under similar circumstances. In cases involving mining rights reservation language like that being cited by Rocky Mountain Energy, the courts held that the surface owners own the minerals up to 200 feet beneath their surface. 1/

The absence of full cooperation from all of the private parties--surface as well as coal rights holders--to a cooperative leasing agreement will likely reduce competition for and revenues from the proposed lease sale to some degree. However, combining less than all the coal and surface rights to a proposed tract may

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1/See Reed v. Wylie, 554 S.W. 2d 169 and 597 S.W. 2d 743.

nonetheless increase competition and revenues beyond what would normally be expected should the Federal and private tracts be sold separately.

The extent of the increases is what cannot be forecast accurately. From the standpoint of economic theory, cooperative leases containing all of the surface and coal rights are clearly preferred, because all the uncertainties about the cost of obtaining additional rights are eliminated. However, packaging leases containing only the coal rights may prove to be desirable as well.

After gaining more experience with cooperative leasing agreements packaging only coal rights, the Department may find that significant increases in competition and revenues cannot be expected. But until more cooperative lease sales of this type are conducted, the Department has no basis for determining the desirability of cooperative leases for coal rights alone. This holds true for the proposed cooperative leasing of Red Rim. Red Rim's cooperative sale would provide the first indication of the extent to which cooperative leases containing only coal rights increase coal leasing competition and revenues.

Participation of land grant railroad mining affiliates in cooperative coal leasing

The Mineral Lands Leasing Act of 1920 (30 U.S.C. 181 et seq.), as amended, prohibits common-carrier railroads from holding Federal coal leases. Current Federal law also restricts a railroad's ability to mine and transport its reserves. Under the Elkins Amendment to the Hepburn Act of 1906 [49 U.S.C. 1(8)] railroads are prohibited from carrying coal that they own--except coal for the railroad's own use, a need that has virtually disappeared since the advent of the diesel locomotive. Although this legislation appears to seriously restrict railroad participation in the coal industry, much of it is considered outdated and ineffective. More importantly, the restrictions are easily circumvented as explained in Justice's reports on "Competition in the Coal Industry".

The May 1978 Justice Department report observes that within 2 years of the Elkins Amendment's enactment, railroads had learned how to evade its prohibition. In the United States v. Delaware & Hudson Company, 1/ the Supreme Court held that, although a railroad could not transport its own coal, it could transport coal of a corporation in which it held stock. Known as the

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1/213 U.S. 366 (1909).

Delaware decision, it was subsequently upheld in United States v. Elgin J. & E. Ry. and in United States v. South Buffalo Ry. 1/ Thus, the Elkins Amendment could be avoided merely by transferring title in the railroad and mining interest to a holding company.

In the same report, the Justice Department concluded that a potentially more serious restriction is imposed by section 2(c) of the Mineral Lands Leasing Act of 1920 which prohibits a railroad from holding a Federal coal lease, except to produce coal for its own use. Pointing out that sections of railroad land contained within the checkerboard patterns are too small to constitute logical mining units, the report concluded that section 2(c), which prevents railroads from acquiring contiguous Federal leases, makes it impossible for railroads to mine coal efficiently.

On the other hand, however, the report noted that the legal effectiveness of section 2(c) is not clear. Apparently, no Federal court has had to decide whether the act would permit a holding company exception. The Justice Department believes it would not because the wording of the prohibition in the Mineral Lands Leasing Act differs from that in the Hepburn Act; thus, it could be read as applying to a broader class of companies. That is, while the proscription in the Hepburn Act expressly pertains to a "railroad company," the proscription in the Mineral Lands Leasing Act pertains to a "company or corporation operating a common-carrier railroad." According to Interior's explanation of the coal leasing prohibition of section 2(c), the limitation does not apply to a subsidiary of a railroad that is a legitimate mining company, and such a company is authorized to hold a lease under the provisions of the Mineral Lands Leasing Act.

In the 1980 report, the Justice Department observed that whatever the merits of a general prohibition on leasing to railroads, the broad sweep of section 2(c) is now an impediment to, rather than a bulkwark of, competition. It then recommended that section 2(c) be repealed. This conclusion has been reached by others, most notably the U.S. Public Land Law Review Commission in its 1970 report One Third of the Nation's Land.

Although the Justice Department considers the blanket restriction of section 2(c) to be inappropriate, according to Justice, it does not imply that the competitive concerns that led to section 2(c) are not valid. According to its report, Justice merely concluded that the competitive issues involved in

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1/298 U.S. 492 (1936) and 33 U.S. 771 (1948), respectively.

leasing to railroads should be handled on a case-by-case basis under the antitrust review procedure of section 15 of the Federal Coal Leasing Amendments Act of 1976 [30 U.S.C. §184(l)(2)].

Under that procedure, Justice reviews each Federal coal lease to determine whether the lease's issuance would "create or maintain a situation inconsistent with antitrust laws." Justice's report explains that the competitive concerns embodied in section 2(c) could be handled on a case-by-case basis under the antitrust review procedure without the detrimental effect on competition that arises from prohibiting Federal coal leasing to all railroads. In our view, this important control should adequately protect the interests of the coal industry, and the public as well.

Regarding the possibility of a railroad's mining affiliate being the winning bidder of the planned cooperative sale of Red Rim, Rocky Mountain Energy Company is a wholly owned subsidiary of the Union Pacific Corporation, which also owns the Union Pacific Railroad and other companies. Rocky Mountain Energy owns the mineral rights to Red Rim's private coal and is expected to bid on the Federal portion of the proposed combined tract. Interior officials anticipate litigation bringing to Federal courts the unresolved issues surrounding the leasing of Federal coal to mining affiliates of land grant railroads. Possible complainants include private surface owners and competing mining companies. Thus, the proposed cooperative lease sale at Red Rim may be the scene of a legal battle to either establish or disenfranchise railroad mining affiliates in the coal industry.

Absent litigation, however, Interior's interpretation of section 2(c) is controlling. Although the Justice Department may not agree with Interior's interpretation, its role in this aspect of Federal coal leasing is purely advisory. The Secretary of the Interior ultimately decides whether to approve or disapprove all Federal coal lease sales, including the proposed cooperative lease sale at Red Rim.

CONCLUSIONS

As custodian of the Nation's coal reserves, the Department of the Interior is responsible for ensuring that the public receives the highest possible return from leasing and development of Federal coal. In discharging this responsibility, the Department must weigh the relative advantages and disadvantages of different coal leasing alternatives and determine which will most likely (1) maximize the Government's return on a given lease property and (2) maintain the proper balance between competing lease sale objectives, environmental and socioeconomic concerns, etc. As an adjunct to established leasing procedures, the Department is experimenting with cooperative coal leasing agreements as a possible alternative for use in checkerboard areas.

In western checkerboard areas small, unmineable Federal coal tracts are divided by alternating private tracts of equal size. There is little competition for checkerboard area leases and, consequently, lease sale revenues are not being maximized. Cooperative leasing conceivably could increase competition, lease sale revenues, and lead to mining of Federal coal that might not otherwise be developed.

The cooperative leasing concept combines both the surface and coal rights to Federal and private tracts--before the actual lease sale. By packaging what are essentially logical mining units in this fashion, the Department hopes to overcome previous market imperfections and--in doing so--substantially increase competition for Federal leases and thus revenues from lease sales. However, packaging all the surface and coal rights to Federal and private tracts is not easy and, in some cases, may not be possible. Packaging less than all the rights to either the private or Federal tract will likely result in smaller increases in competition and lease sale revenues. Because the Department has not conducted its first cooperative lease sale, the extent to which full or partial implementation of the concept might increase competition or lease sale revenue is still uncertain.

Presently, the Red Rim tract in the Green River/Hams Fork Federal Coal Region of northwest Colorado and southwest Wyoming is the only combined Federal/private coal tract being considered for cooperative leasing. Difficulties in obtaining consent from the private surface owner and unresolved legal issues surrounding participation in Federal leases by the mining company affiliates of land gr nt railroads complicate the proposed lease sale. The possibility of litigation may persuade the Department to withdraw the Red Rim tract from consideration of a cooperative lease sale. Moreover, this less-than-ideal first experience may jeopardize future use of the concept as well.

Whether or not the proposed Red Rim sale is conducted under the mantle of cooperative leasing, we believe it would be imprudent to decide from one experience on the concept's merit as a coal leasing alternative. More data are needed on the impact of cooperative leasing on competition and lease sale revenues, including instances where only part of the surface or coal rights can be packaged before the actual lease sale.

The Red Rim cooperative lease sale--although not containing all the surface and coal rights--should provide the first indication of the merits of the concept. The initial data, together with data from future cooperative lease sales, are needed to determine the concept's impact on competition and revenues. Without this information, meaningful comparisons against other leasing alternatives cannot be made.

The Department should obtain more experience with cooperative leasing before deciding on the future utility of the concept. During the current period of fiscal austerity, however, a timely, efficient, and effective way to plan and conduct future cooperative coal lease sales is required. Stronger public participation, including industry as well as private surface owners, is one means of streamlining Federal efforts and ensuring concept application in a manner consistent with the underlying theoretical basis.

RECOMMENDATIONS

To bring the cooperative leasing concept out of the realm of theory and into the reality of practice, we recommend that you continue efforts leading to the cooperative leasing of the Red Rim tract. Data from this first cooperative lease sale will provide an indication of the concept's merit. Although not all the surface and coal rights are included in the proposed Red Rim tract, the Department nonetheless needs information on the extent to which even partial implementation of the cooperative leasing concept will impact competition and revenues. The data from Red Rim, together with data from future cooperative lease sales, will provide a sound foundation needed for an intelligent decision on the continued use of the concept.

Further, to facilitate continued use of the concept as an alternative for developing Federal coal within the framework of the Federal coal leasing program, we recommend that--in planning future leasing activities--you (1) take steps, such as announcements in the Federal Register or other media, which could lead to increased submittals of cooperative coal leasing proposals from private parties holding surface and coal rights to lands adjoining Federal coal holdings; (2) identify to the public where cooperative leasing proposals could be incorporated into the existing coal leasing program; and (3) give priority to cooperative coal leasing proposals containing all the surface and underlying coal rights.

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A draft of this report was sent to the Assistant Secretaries for Land and Water Resources, and Policy, Budget, and Administration. Its contents have been discussed with Interior officials and the Cooperative Leasing Task Force, and their comments have been incorporated where appropriate. These officials raised no substantive questions concerning the analysis of the issues and treatment of the facts presented in our draft report, and found our suggestions helpful and constructive.

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As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We appreciate the courtesy and cooperation extended our staff during this evaluation.

Sincerely yours,

for Douglas Shellard

J. Dexter Peach
Director

Statement Prepared for the Record

by

the American Petroleum Institute

for

Hearings on Coal Leasing Amendments to

the Mineral Leasing Act

U.S. Senate Committee on Energy and Natural Resources

Subcommittee on Energy and Mineral Resources

August 3, 1982

The American Petroleum Institute--a trade association composed of more than 320 member companies, with over 8000 individual members engaged in every aspect of the petroleum industry--has a strong interest in the issues raised by the Federal Coal Leasing Amendments Act of 1976 (FCLAA). Many API members are current holders of federal coal leases (either directly or through affiliates) and these companies and other API members are potential participants in future federal coal lease sales. Whether these leases are part of a conventional coal mine or a synthetic fuel project, API members believe it is essential that the Congress address several critical problems that arise from the currently inflexible production requirements of FCLAA.

Importance of Federal Coal

According to the Department of Interior's Federal Coal Management Report for FY 1981 (an annual report mandated by FCLAA), the federal government owns one-third of the nation's coal reserves and indirectly affects the use of at least another

twenty percent. More than 75 million acres of coal land (located primarily in the western states) are owned and administered by the federal government. The federal lands in the West contain as much as sixty percent of the total western coal reserves.

Since the 1973 oil embargo, national energy policy has recognized the important role which coal must play in meeting our domestic energy needs. Congressional and Administration policies in the intervening years have continued to emphasize greater reliance on domestic fuels, especially our most abundant domestic fuel -- coal -- either through its direct burning or as a feedstock for synthetic fuels. When Congress passed the Energy Security Act in 1980, it envisioned a substantial coal-based synthetic fuels industry to supplant imported oil. Western coal reserves generally are most amenable to development through large mining operations particularly suited to support commercial synthetic fuel projects. Due to the federal government's extensive resource holdings, western federal coal reserves will play a crucial role in the creation of a mature coal-based synthetic fuels industry. Federal coal production (as well as federal coal-based synthetic fuels production) will be dependent largely upon federal coal lease management policies developed by the Department of Interior as guided by Congress. In reviewing the FCLAA at this time, Congress has the opportunity to provide revised guidelines for federal coal development and, thereby, to reduce significantly our country's dependence upon foreign fuel supplies.

Problems with FCLAA

The Federal Coal Leasing Amendments Act of 1976 mandates inflexible production requirements which prevent the federal coal leasing program from adjusting to the changes which have occurred since its passage. The unforeseen (in 1976) slackening in demand for all forms of fuel, deferral of planned electric generating capacity, the impact of subsequent passage of the Surface Mining Control and Reclamation Act, and increasingly stringent state siting constraints for synthetic fuels facilities and power plants have all had substantial impacts on both the market for coal and the lead times necessary to develop federal coal leases--impacts to which the FCLAA in its present form is unable to respond. And, the future is no easier to predict now than it was in 1976. If Congressional encouragement of synthetic fuels (as evidenced by the Energy Security Act) is to be meaningful, Congress must amend FCLAA so that it does not impede the subsequent Congressional mandate to bring synthetic fuels on line.

Particular concern must center on the problems arising from the two ten-year commercial production requirements in the FCLAA. The first, and more important, of these requirements is contained in Section 3 of the FCLAA, which has been interpreted to prohibit the Secretary of the Interior from issuing any Mineral Leasing Act (MLA) leases (coal, onshore oil and gas, tar sands, oil shale, etc.) to an entity that "holds a lease...and has held (the) lease for...ten years when such entity is not...producing coal in commercial quantities" from that lease. August 4, 1986

is the deadline for all pre-FCLAA leases to be in commercial production under Section 3.

The second ten-year requirement is contained in Section 7 (a) of the Mineral Leasing Act as amended by FCLAA. This section specified that any lease not producing in commercial quantities at the end of ten years shall be terminated.

These dual ten-year requirements are not responsive to the realities of bringing a federal coal lease into production, chiefly because of the lead times involved. For leases dedicated to a synthetic fuel project the problem is even more severe. A fourteen to seventeen year lead time from lease issuance would not be unusual, assuming favorable economic and market conditions. And this estimate does not include delays due to environmental requirements, poor market conditions, or unusual financing problems.

The potential for delay associated with the various environmental reviews must be emphasized. The technological demands of western coal development have dictated large mines in the West requiring the assembly of large logical mining units (LMU's) regardless of the end use of the coal. As a general rule, the larger the project, the longer the environmental reviews especially when the project is of a size that triggers special reviews under environmental or siting laws in certain states.

Impact of Section 3

A recent study by the Office of Technology Assessment[1] reported that 527 of the 565 existing federal leases (prior to the new 1979 leasing program) in the western states are pre-FCLAA leases and thus covered by Section 3. OTA determined that only forty-three percent of these leases were likely to meet the Section 3 production deadline. As discussed earlier, the lead times involved in developing leases for synthetic fuels and for certain large conventional coal mines preclude compliance with Section 3. While some portion of the remaining fifty-seven percent must be considered "undevelopable," a substantial percentage could be developed beyond 1986 if the Section 3 requirement did not exist.

The sanctions of Section 3 have the potential to impact many leases and companies in 1986. A study of the OTA's data reveals that at least 66.7% of lessees in the western states hold at least one lease that is unlikely or uncertain to meet the Section 3 commercial production deadline by 1986. Of the seventy-two publicly-owned companies[2] holding federal coal leases, forty-nine are also involved in oil and gas development; four are involved in federal oil shale leases. Since the

1/ OTA, An Assessment of Development and Production Potential of Federal Coal Leases, 1981.

2/ Lessees include small and large energy companies, electric utilities, and diversified non-resource companies. Less than thirty percent are among the top forty domestic producers of bituminous coal and lignite. Even fewer are among the top forty domestic producers of oil and gas.

federal tar sands leasing and the permanent oil shale leasing programs are just beginning, the extent of any conflict with these programs is unclear but would be significant. Many companies, therefore, are faced with the Section 3 sanctions which could disrupt oil, gas, coal, synthetic fuels and other mineral operations.

If a company does not expect Section 3 to be changed, it must decide soon to either (1) retain federal coal leases and risk losing the right to obtain other MLA leases for onshore oil and gas, coal, tar sands, oil shale, etc., or (2) retain the right to obtain other MLA leases and sell or relinquish currently held federal coal leases. However, sale or relinquishment may be illusory alternatives. First, the coal lease may have little or no market value. Second, relinquishing coal leases may not be an alternative. Current and proposed federal coal leasing regulations permit relinquishment on the conditions that there is a "satisfactory showing that the public interest shall not be impaired" by surrendering the lease. This condition has not been defined by DOI, but an adverse interpretation of the language could nullify relinquishment as a method of avoiding the Section 3 sanction. A review of recently processed relinquishments show that the process is quite variable in the length of time required to accept such relinquishments, from a few months to as much as twenty-three years in one case.

The direct result of Section 3 could well be reduced competition, either for federal coal leases, or for other MLA leases, or -- most likely -- both. Companies now holding leases subject to Section 3 may be forced to choose between continuing to hold coal leases or obtaining future federal leases for other minerals leasable under the MLA as well as coal. Even companies which may be interested in becoming diversified synthetic fuels producers will find themselves limited to pre-deadline federal reserves only since new federal leases for coal and other synthetic fuel resources (oil shale and tar sands) will be unobtainable. Such a situation not only limits competition, but also constricts the range of technological diversity and innovation essential in the early stages of a new industry's emergence.

It is important to point out that even if Section 3 were eliminated in its entirety, the diligent development requirements of Section 7 would remain. The Solicitor's Office of DOI has determined that the production requirement of Section 7(a) applies to pre-FCLAA leases upon their first readjustment following the enactment of the FCLAA. These diligent development requirements and the Solicitor's determination should considerably temper the Congressional fear, (originally expressed during debate at the time FCLAA was enacted) that non-production from coal leases would result should Section 3 be repealed.

Impact on Synthetic Fuels

In addition to the extensive problems for synthetic fuels created by Section 3, the emergence of a synthetic fuels industry will also be affected by other provisions of the FCLAA. As discussed earlier, the lead times for synthetic fuels projects

will extend beyond ten years under any realistic project development schedule; therefore, Section 7(a) in its current form is insufficient for synthetic fuel lead times and will effectively preclude the utilization of newly-leased federal coal in synthetic fuels projects. With the Department of the Interior embarking on an ambitious coal reserve leasing program over the next two years, Section 7(a) will significantly reduce the competition for such leases by effectively barring potential sponsors of synthetic fuel projects from the bidding.

In addition, Section 5 of the FCLAA requires exhaustion of the lease coal reserves within forty years of the establishment of an LMU. While forty years should be adequate for the majority of conventional coal mines, mines supporting synthetic fuels projects may need to produce over longer periods in order to justify the multi-billion dollar project investment. An assured supply of coal for the full life of a synthetic fuels project is necessary before private operators will decide to invest in these substantial capital undertakings.

Legislative Remedy

API strongly recommends that the Congress amend the FCLAA to address these problems by:

Repealing Section 3 - The many problems caused by this section dictate outright repeal as the best solution. Congressional concern for obtaining coal production from federal leases is adequately addressed in Section 7 of the MLA, as interpreted by the Solicitor's Office of DOI.

Modifying Section 7(a) - Congress should recognize in the statute that the existing ten-year commercial production deadline in Section 7(a) seriously threatens the emergence of a coal-based synthetic fuels industry. Accordingly, Section 7(a) should be amended to authorize a more realistic production deadline (at least fifteen years) for federal coal leases with reserves dedicated to synthetic fuels projects.

Modifying Section 7(b) - Allowing payment of advance royalties in lieu of initial "commercial production" obligations (in addition to "continued operation" as in the present law) for a reasonable time will add needed flexibility to the proposed fifteen year production deadline of Section 7(a) without jeopardizing the goal of getting federal coal leases into production, and generating revenues to the government. Both the federal and state governments would receive timely coal revenues while allowing lessees, willing to pay the "price," sufficient flexibility to address production timing constraints, which may be beyond their control for both conventional and coal-based synthetic fuels projects.

Repealing Section 5 - The requirements of Section 7 for "producing in commercial quantities" and "continuous operation" will assure that mines will go into production and stay in production until reserves are exhausted. Repeal of Section 5 will permit projects (such as synthetic fuel plants) requiring long production periods to justify the necessary investments.

Conclusion

The API believes S.2704 best expresses the legislative remedies which are required. The most important of these remedies is the repeal of Section 3. Repeal of Section 5 and amendments to Section 7 are also needed. Of particular value--especially as contrasted with the House version (H.R.5895) of amendments to the MLA--is the synthetic fuels provision of Section 5 of S.2704. Providing a more realistic base period of fifteen years for achieving commercial production of leases dedicated to synthetic fuels projects will eliminate a major obstacle to development of the coal-based synthetic fuels industry. However, API suggests a modification of the language of the synthetic fuels provision, specifically the sentence which provides that "production in commercial quantities can be satisfied by the initiation of construction of a synthetic fuels facility." API supports this concept because many synthetic fuels facilities will be built in modular stages where production comes on line in steps and therefore initial coal production levels may not qualify as "commercial production" and because of the potential need for a non-extractive definition of "production in commercial quantities" in certain cases. Nonetheless, API believes that these concerns could be addressed more appropriately in regulations rather than in legislation. Consequently, API recommends that this sentence be deleted.

With this minor change, the API supports S.2704 as a bill which would remove significant obstacles to the development of needed energy resources, including synthetic fuels from federal coal leases.

FRIENDS OF THE EARTH

530 7TH STREET, S.E., WASHINGTON, D.C. 20003
(202) 543-4312

Statement of Friends of the Earth to the Senate Energy Subcommittee on Energy and Mineral Resources, August 3, 1982.

Submitted by L. Geoffrey Webb, Legislative Representative

Mr. Chairman, Friends of the Earth appreciates the opportunity to make a short statement for the record in support of the testimony given today by the Western Organization of Resource Councils and the National Wildlife Federation, on behalf of the many concerned citizens' groups who are not appearing before you today.

Friends of the Earth is a national membership organization concerned with the wise and effective use of our natural resources. We have a longstanding interest in the use (and abuse) of Federal coal lands and actively participated in the legislation governing land use policy (FLPMA, 1976) and coal lands in particular (FCLAA, 1976). We support the principles of these laws, namely that the public's land be managed for a variety of uses, that the public obtain a fair return on the property it chooses to sell or lease, and that profits are intended to reward production, not land speculation at public expense.

It is our belief that S. 2704 is contrary to these principles, and indeed seeks a return to times past, when the landowners' interests were subordinated to those of a few large energy and mining companies. We find ourselves with an Administration hopeful that it can turn back the clock without regard to the circumstances which brought about the reforms of the last decade.

The simple fact is that the longstanding abuses of the land have been so pervasive, so "shameful", to use Secretary Watt's word, that President Nixon was forced to put a halt to all Federal coal leasing. But those who negotiate with the Secretary of Interior for access to our property know that none of them has

yet lost a lease. A recent poll of mine operators shows their confidence in this Administration's ability to change the rules where possible, and to get the laws changed where necessary.

Many of those who are most vocal in support of relaxing anti-speculation provisions profess to be deeply concerned about America's energy future and the need to become more productive. Indeed they often cannot see the irony in holding both positions: that as a nation we can only benefit by producing on leases, not by having private parties barter among themselves for the rights to our lands 40 years in the future. The Interior Department has recently admitted that its own unprecedented coal leasing program will probably not result in any additional production whatsoever. Their claims of interest in recapturing property through diligence provisions proved spurious last Friday when the Department announced the abolition of the old diligent development rules for pre-1976 leases and the institution of a new standard restoring coal speculation to legal status.

We oppose the adoption of S. 2704, urge careful consideration of all aspects of the bill, welcome discussion with members of this Committee and the Senate, and support the testimony given today by the Western Organization of Resource Councils and the National Wildlife Federation.

ARIZONA PUBLIC SERVICE COMPANY
P. O. BOX 21666 · PHOENIX, ARIZONA 85036

RUSSELL O. HULSE
VICE PRESIDENT

July 29, 1982

The Honorable John Warner
Chairman
Senate Subcommittee on Energy and Mineral Resources
Russell Senate Office Building
Washington, D. C. 20515

RE: S.2704 -- A Bill to Amend the Mineral Lands Leasing Act of 1920

Dear Senator Warner:

In anticipation of hearings scheduled to be held by your Subcommittee on August 3, 1982, Arizona Public Service Company (hereafter "APS" or the "Company") hereby submits for your consideration its observations and suggestions regarding S.2704.

APS is an investor-owned public utility serving over 400,000 customers with electricity within a 50,000 square mile area in the State of Arizona. The Company currently relies upon a fuel mix of oil, coal, and natural gas as a means of electrical generation, with coal constituting its base loading fuel. During the course of 1983, APS anticipates bringing on line the first unit of the Palo Verde Nuclear Generating Station, a project in which it is participating with various other electric utilities serving portions of New Mexico, Texas, Arizona, and California.

In addition, the Company's wholly-owned subsidiary, Malapai Resources Company (hereafter "Malapai"), shares an interest with two other entities in 21 federal coal leases and 12 State of Utah Coal Leases, aggregating approximately 47,000 acres upon the Kaiparowits Plateau in Kane County, Utah. These coal reserves were acquired in the early 1960s as a fuel source for the Kaiparowits Generating Station, a mine mouth power plant which would have provided electricity to Arizona and Southern California; however, due to various considerations (including environmental opposition), the Project Participants determined in 1976 not to proceed with the power project. Nevertheless, Malapai and its

coparticipants have, since that date, continued to expend time and money in reliance of their leasehold interests seeking opportunities to develop this coal resource.

Our purpose in writing to you today is to express our general support for S.2704. The Company believes that the absolute sanctions contained in Section 3(a)(2) of the Federal Coal Lease Amendments Act of 1976 constitute an undue burden and run counter to the national goal of energy independence. Although Section 3(a)(2) was intended to impede speculation, it must be remembered that speculation is not the only factor which has contributed to the lack of development by some federal coal lessees. Other considerations, some of which are beyond a lessee's control, have compelled suspension of development programs. These include adverse economic circumstances, permitting delays (exacerbated in some instances by environmental opposition), and absence of markets (occasioned by the economic environment and in some instances the absence of transportation or competitively priced transportation alternatives). Section 3(a)(2) would indelibly brand the speculator and the good faith coal producer alike resulting in a gross inequity. On the other hand, the diligent development and advance royalty provisions contained in Section 5(b) of S.2704 provide a more reasonable inducement to further development of federal coal leaseholds.

While it supports the diligent development advance royalty concept established in Section 5(b), the Company suggests a variation of the concept for your consideration. It is well recognized that the development of a coal mine is an expensive proposition in today's economic climate. We noted previously factors which contribute to delays or suspensions in mining programs; and those same considerations can combine to render infeasible an otherwise sound mining venture. Given these financial constraints, we think it reasonable to allow coal operators to credit against the Section 5(b) diligence royalty dollars they invest in furtherance of development. The inducement created by the advance royalty is in no way diminished (for if no dollars are spent, the royalty must be paid in full); but if dollars are to be spent, the credit allows them to be channeled directly into development where (and at a time when) their expenditure can do the most good. If the lessee is not allowed this credit, it may be required to finance

the deficit resulting from the advance royalty payment,[1] resulting in higher mining expenses (given current interest rate levels) and hence higher costs to the energy consumer. We believe the development credit makes sense and in no way compromises the effectiveness of the advance royalty as a means of inducing production; in fact, we believe it furthers coal development. Exhibit A annexed to this letter contains suggested language effectuating the credit concept.

We wish to offer another comment which we believe is necessary in order to clarify the intention of Section 5(b). In conversations with representatives of the American Mining Congress, we were advised that the advance royalty provisions of S.2704 are intended to apply to leases issued prior to August 4, 1976, after the expiration of the 10-year diligence period contained in Section 378.302 of the proposed regulatory revisions published by the Department of Energy on December 22, 1981 (46 Federal Register 62226); hence, the diligence provisions of S.2704 are not applicable to a pre-August 4, 1976, lessee until the expiration of 10-years following the date the lessee's lease was first readjusted. A review of Section 5(b) [and Section 5(c) of H.R. 5895 -- S.2704's House counterpart] does not indicate

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[1] The diligence advance royalty will be a significant annual payment. If we assume that a federal coal leasehold or logical mining unit contains 100 million tons of recoverable coal which has a market value of $25 per ton (F.O.B. Mine), the advance royalty would be $2 million per year for an underground mine (e.g. 1% of the recoverable reserves or 1 million tons multiplied by $25 multiplied by the 8% tonnage royalty prescribed by regulation) and $3.125 million per year for surface mined coal (e.g. 1 million tons multiplied by $25 multiplied by the 12.5% tonnage royalty prescribed by regulation). The language in Section 5(b) is somewhat unclear and we base these calculations on interpretations confirmed by the American Mining Congress. To add clarity to the statutory provision, the Company proposes the modifications underscored in Exhibit A annexed to this letter.

that this intention is clearly reflected. The Company proposes for your consideration that language, underscored on the attachment hereto, as a means of eliminating potential confusion.

In conclusion, APS supports efforts designed at broadening the development of domestic coal resources. An endeavor of this nature assures the Nation an ample available fuel supply at competitive prices. However, the methods by which this goal is attained must be carefully designed, lest they result in a constriction of the domestic development base. We must take care that in solving one problem we do not create another, more significant one.

We thank you for this opportunity to air our views on the subject of S.2704. My staff and I would welcome the opportunity to discuss with you or your staff the suggestions contained in this letter should you desire to do so.

Very truly yours,

Russell D. Hulse

RDH:HIZ:av
Enclosure

cc: The Honorable James McClure
Chairman
Senate Energy & Natural Resources Committee
3121 Dirksen Senate Office Building
Washington, D. C. 20510

1268L

Exhibit A

30 U.S.C. § 207(a) and (b)
Mineral Leasing Act of 1920
with Clarifying Language Underscored.

(a) A coal lease shall be for a term of 20 years and for so long thereafter as coal is produced annually in commercial quantities from that lease. Any lease which is not producing in commercial quantities at the end of ten years shall be terminated except as provided in subsection 7(b). The Secretary shall by regulation prescribe annual rentals on leases. A lease shall require payment of a royalty in such amount as the Secretary shall determine of not less than 12 1/2 percentum of the value of coal as defined by regulation, except the Secretary may determine a lessor amount in the case of coal recovered by underground mining operations. The lease shall include such other terms and conditions as the Secretary shall determine. Such rentals and royalties and other terms and conditions of the lease shall be subject to readjustment at the end of its primary term of 20 years and at the end of each ten-year period thereafter if the lease is extended.

(b) Each lease shall be subject to the conditions of diligent development and continued operation of the mine or mines, except where operations under the lease are interrupted by strikes, the elements, or casualties not attributable to the lessee. Upon application by the lessee, the Secretary of the Interior, unless he determines that the public interest will not be served thereby, shall suspend the condition of continued operation or the requirement of production in commercial quantities or any requirement for production as constituting diligent development upon the payment of advance royalties. Such advance royalties in lieu of continued operation shall be no less than the production royalty which would otherwise be paid and in lieu of production in commercial quantities or production constituting diligent development shall be at a rate equal to the production royalty which would otherwise be paid on 1 percentum of the recoverable lease reserves; provided, however, that with regard to leases issued prior to August 4, 1976, no lessee shall be required to pay any advance royalty in lieu of production constituting diligent development as provided for in this subsection until the expiration of ten years after the lessee's lease is first readjusted. There shall be credited against each annual installment of the advance royalty payable in lieu of production constituting

diligent development all sums expended by the lessee during the 12 month period immediately preceding the date upon which the advance royalty is to be paid for the purpose of attaining diligent development. The aggregate number of years for which advance royalties may be accepted on any lease shall not exceed ten. The amount of any production royalty paid for any year shall be reduced (but not below 0) by the amount of any advance royalties paid under such lease to the extent that such advance royalties have not used to reduce production royalties in a prior year. No advance royalty paid during the initial twenty-year term of a lease shall be used to reduce a production royalty after the twentieth year of a lease. The Secretary may, upon six months' notification to the lessee cease to accept advance royalties in lieu of the requirement of continued operation.

SUPPLEMENTAL TESTIMONY

OF

JAMES R. JONES

Vice President,

Environmental Affairs

PEABODY COAL COMPANY

On Behalf Of

The

NATIONAL COAL ASSOCIATION

On

S.2704

To Amend The Mineral Lands Leasing Act Of 1920

Before The

Subcommittee on Energy and Mineral Resources

Of The

United States Senate

August 3, 1982

Washington, D.C.

INTRODUCTION

This written testimony is submitted in accordance with the reference on page 19 of the oral and written testimony presented by Richard M. Holsten, Jr., President, Pittsburg & Midway Coal Mining Company on behalf of the National Coal Association before the Subcommittee on Energy and Mineral Resources, United States Senate, August 3, 1982. This material updates a prior paper presented by the author at the National Western Mining Conference and Exhibition of the Colorado Mining Association, February 4, 1977, entitled, "The Process of Developing A Western Coal Mine."

Unlike a manufactured product, coal is not produced for sale "off-a-shelf or over-a-counter." A western coal mine is developed to supply a specific customer, whose fuel burning equipment is designed or altered to burn that specific coal. As will be noted in the text which follows and the attached chart, the process of developing a mine is long and complex. It will be seen that:

- Thirteen or more years can be required from lease issuance to initial production.

- Fifteen or more years can be utilized before full production.

BACKGROUND

Since that time, several federal and state laws have been enacted which have a major impact upon the coal mining industry. The regulations resulting from these laws are voluminous and have significantly extended the time required to develop a western mine on federal, state, and private lands. The Department of Interior Regulations implementing the Federal Coal Leasing Act Amendments of 1976 (FCLAA) have significantly altered the early stages of the process of developing a western mine. In addition, the Surface Mining Control and Reclamation Act of 1977 (SMCRA) and the subsequent regulations issued by the Department of Interior's Office of Surface Mining (OSM) have materially extended the permitting process. The combination of these two Acts has revised compliance with the National Environmental Policy Act by now providing for an environmental assessment before issuance of the exploration license, a regional type Environmental Impact Statement prior to the issuance of a lease, followed by a site-specific Environmental Impact Statement published before issuance of a mining permit submitted in accordance with SMCRA.

It should be recognized initially that the process of developing a surface mine, particularly in the West, is a very lengthy one. Unlike a manufacturing industry, coal mining does not produce a product "for the shelf," waiting for

customers to come and purchase the merchandise. Production from a large western coal mine is not started until a long-term contract has been negotiated with a customer. These contracts will frequently run for 20 to 35 years, but may not commence delivery until 5 or more years after the contract is signed.

Prior to the signing of the contract, the coal operator has a long period of development time for acquiring the necessary surface and coal by purchase or lease. Extensive analyses from a lengthy drilling program are required in order to demonstrate to the prospective customer not only the amount of coal available, but also that the coal is of sufficient quality and consistency. A utility boiler, for instance, is designed to burn a specific fuel; therefore, the utility insists upon knowledge of the degree of variability of that coal quality to be burned over the life of the contract. A boiler does not burn "averages."

When the coal operator first begins to plan for a mine, he does not have a customer. He has, however, conducted long term studies projecting energy growth patterns, potential air pollution requirements and competitive methods of energy production. In addition to those factors, he will be conducting studies on potential methods of transportation. Ultimately, there will be a marriage between a particular coal mine, a particular method of transportation, and a site-specific electric generating station or synthetic fuel plant. Since

this must be a long-term marriage for all three parties to the agreement, the potential pitfalls, alternatives and economics must be evaluated. These discussions can extend over a period of several years. The lead time for the mine, the transportation medium and the end user has extended significantly over the past ten years.

All of these requirements add up to greater front-end investment costs, significantly greater risks, and potentiality for abandonment of a project somewhere in the development phase. Varying and uncertain governmental policies play a major involvement in this risk.

This testimony will describe the major steps in the mine development process. Essentially, they are the same ten steps discussed in the paper presented in 1977, with two additions:

(1) A formalized exploration program has been developed to accomplish the goals of the Amendments of 1976 to the Federal Mineral Lands Leasing Act (MLLA). All of this must take place before the issuance of a lease.

(2) The passage of the Surface Mining Control and Reclamation Act and adoption of the subsequent regulations now require an Environmental Impact Statement to be completed before issuance of the surface mining permit on federal lands under that

Act. Thus, on the bar chart for the 1977 version appended to Mr. Holsten's testimony you will now note that the permitting and the NEPA process were reversed from Figure 1, attached.

MAJOR STEPS IN MINE DEVELOPMENT PROCESS

There are 10 major steps required in the mine development process. I will describe the activities under each step and refer to a timing-bar chart (Fig. 1) to illustrate how these follow a format. Constraints and uncertainties which effect each step will also be discussed.

All companies do not utilize the exact same procedures, because of variations for site-specific situations, corporate management policies, and varying governmental policies. Soon after the operator receives the lease he must make a number of basic decisions relative to the process by which he will develop the reserves; all of which are constrained by the fact that the production build-up period cannot commence until a customer has contracted for the coal output. All ten steps involved in the process and described later in the text must be performed. However, the order in which these steps are conducted does have some flexibility.

One option is to completely develop the mine through the construction of the physical facilities and then await a signed contract before commencing shipments. This, of course,

involves heavy capital expenditures. A second option is to proceed along a similar path but to stop prior to the start of construction. In this option the capital expenditures are still significant, but greatly reduced over option 1. The risk involved is that the mining plan which has received all the necessary permits may not match with the requirements of the customer. Thus a revision of the mining plan may require additional approval. Another risk is that some of the permits will expire before mining operations begin, thus necessitating renewals which may encounter some difficulties.

A third option, the one used in this testimony, has the least capital intensive risk, i.e., to proceed with the permitting phase, design and complete environmental data gathering only after the contract with the customer has been signed. This option has the advantage in that the long lead time for the customer to design and permit the coal consuming facility is simultaneously utilized for mine plan development. Thus the supplier and consumer can proceed utilizing the same lead time. Normally, a large user will contract for the fuel supply years in advance of startup of the facility. This illustrative example was developed for a 5,000,000 ton per year mine, with a 35-year life minimum. Timing requirements are not directly proportional to mine size. The timing for each site-specific mine must be determined for that situation.

I. ASSEMBLY OF A MINEABLE COAL PACKAGE

The first major requirement is to assemble a mineable coal package. The package can then be offered in response to a bid request from a prospective customer or to have available as a reserve while seeking a market. This is a continuing process that can extend for two or more years. Activities proceed at an intensive pace in the early years and then slacken off as the mine nears the operations phase. The functions to be performed along with the constraints are enumerated in the following pages.

1. Coal Ownership or Lease

The issuance of the lease by the Bureau of Land Management (BLM) commences the due diligence period and is but one element in developing a reserve. The coal operator may also have to obtain a state lease or the right to mine from private owners of adjacent or interspersed properties. Ownership in the West is frequently in a checkerboard pattern, with the surface estate often under different ownership than the coal. Thus, a proposed mine could have federal, state and private coal as well as federal, state and private surface, which do not overlay the same sections.

2. Drilling Program Development

While the exploration program included a good deal of drilling to ascertain overall coal quality and quantity, that level of information is totally inadequate from a commercial standpoint for marketing purposes. Therefore, a much more extensive drilling program must be initiated. This expanded drilling program must comply with the exploration provisions of the regulations under SMCRA as well as any regulations issued by the state.

In addition, drilling rights will have to be obtained from the state for state owned sections where it has ownership of the coal and from the private owner of any unacquired sections. It is logical to obtain all of these drilling approvals before starting the actual field work in order to have a most efficient utilization of the drill rigs. Unfortunately, this does not happen in practice. Instead the drills have to be moved from section to section, sometimes in an illogical order only because drilling rights may not yet be available on certain sections.

3. Surface Rights Acquisition

Because surface ownership or control is often different from that of the underlying

coal, negotiations for the surface must compliment and be conducted simultaneously with coal drilling rights. Usually the surface acquisition will contain some sort of an option for acquiring mining rights, providing the drilling program determines the project to be feasible.

4. Drilling, Sampling, Logging, Analysis

Once the legal rights for drilling have been obtained, the actual core drilling program must be developed. Each drill hole must be logged, the sample prepared for shipment to the laboratory, and the analysis determined.

This initial drilling will probably be accomplished on approximately 660 ft. centers with additional drilling on 165 ft. centers along the crop and burn lines. The purpose of this drilling program is to obtain more defined knowledge of the coal reserve, its physical and geological conditions and analytical characteristics in order to satisfy marketing needs. At this point, we are not obtaining complete data for coal utilization purposes, nor for the detail mining plan that ultimately must be submitted to both the state and OSM as well as other regulatory agencies.

5. Determination of the Commercial Quantities Present

The results of the drilling program must be analyzed and a determination made of whether there are commercially mineable and marketable coal reserves present. This becomes a judgment factor on the part of the operator. If the answer is "yes," he is then committing himself to substantial capital requirements to move forward in the coal mine development process.

6. Drilling on Closer Centers

If the "green light" still prevails, the drilling program must be expanded to drill on closer centers in order to obtain further information necessary for engineering of the mining plan and acquisition of data that will be required by a prospective customer for boiler design. This is shown on the chart in dotted form.

7. Sampling, Logging, Analysis

These steps must now be continued for the additional drillholes.

II. MARKET DEVELOPMENT

The second major function under mine development is that of market development--a customer or customers must be found. It can take five or more years to accomplish

the following actions. The prospective customer has long lead time activities and options to consider before arriving at a decision to proceed with a coal consuming facility.

1. Market Survey

A very preliminary market survey will have been conducted prior to bidding on the lease. Marketing activities will be intensified as the initial phase of assemblying a mineable package is nearing completion. Such questions as these need to be answered: Where are prospective new plants to be built? What are the potential methods of transportation? What are the environmental regulations with regard to utilization of the coal in these potential market areas?

2. Potential Customer Identification

Armed with the data generated from the drilling program, the salesman is now equipped with the information regarding the approximate size of the coal reserve, and its quality, so that he can begin active discussions with potential customers. His prior market survey work should indicate the prime locations of prospects.

During this same period of time, the customer is studying his various options of potential fuel supply. He will be considering such questions as these:

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- By what year are his energy needs for coal projected?

- What planning lead-time is required?

- What air pollution regulations will apply for each study area in the future when permit applications are to be submitted? Past experiences have shown that such requirements will often change between planning and the start of permitting.

- Are the options for fuel sources for a long-term commitment so restricted that he is in a difficult position for negotiating the lowest ultimate fuel cost for the new plant?

- For boiler operation purposes, what will be the variability of the sulfur content of the received coal on an annual basis? On a monthly basis? On a weekly basis? On a trainload shipment basis?

- Can one supply source meet all of the requirements, or is the user going to have to build a sophisticated blending

plant for two or more sources of supply of differing sulfur content?

These are some of the uncertainties the customer faces, all of which are seriously affected by governmental action. Developing the answers to such questions can take lengthy periods of time, often several years. The coal operator may have insufficient data to answer and respond to some of those specific concerns. Additional information may have to be developed.

3. Letter of Intent to Develop and Supply

Once discussions have narrowed down to a specific mining location, and a specific area for the consuming plant, the coal operator and prospective customer are ready to enter into a Letter of Intent to sell and purchase coal. The drafting of the Letter of Intent will take a fair amount of time, and will include the language to describe the general intent of the two parties, the range of subject matter to be included in the eventual coal supply agreement and the necessary commitments of capital on the part of both parties.

4. Contract Negotiation

Contract negotiations can consume a year or more of discussions. The range of subjects to be included in the contract are extensive. Provisions must be made for the total amount

of the reserve which will be dedicated to the agreement, annual shipments, coal quality specifications, rejection limits, methods of transportation, price escalation provisions, termination proceedings, extensions of contract period, and a host of contingency provisions. These are but some of the items which must be incorporated into the long-term contractual commitment.

III. ENVIRONMENTAL AND RELATED STUDIES

Environmental and related studies begin during the initial exploration or very early in the development process, intensify during the permitting stage, and continue at a lower level of monitoring and compliance activity during the mining operation itself. These activities virtually extend through the entire process of developing and operating a mine. Some of the steps required will be briefly enumerated:

1. Initial Reconnaissance

Some of the early reconnaissance will be accomplished druing the pre-lease period. This includes driving and walking through the area, an inspection of vegetation, soils, topography, drainage pattern, and obtaining a photographic record of the area of interest. It may also include a prelininary study of

surrounding lands and their use. In addition to the general physical observation, a very preliminary investigation will be made of environmental data already available from universities, government agencies, publications, etc.

The resulting report will highlight the major areas of environmental concern. Particularly, the operator is looking for any potential serious environmental constraint which may prohibit mining in the area. This information becomes part of the early decision of whether to proceed with bidding for a lease. Several months will be consumed in this initial reconnaissance.

2. Scope of Work Development

Once a lease is issued and the company further defines development plans, an environmental scope of work to be performed, along with the time schedule and projected costs, needs to be proposed for management approval. Preparation of this scope of work includes consultation with various governmental agencies to make certain that all of the areas of environmental concerns are to be considered.

3. Consultant Selection

After the scope of work is outlined, the operator will have to make a decision as to what portion of

the work will be performed by his own employees versus those from outside consultants. Requests for proposals from a number of consultants are normally sought and these responses reviewed for a final selection. From that point on, Project Managers from the consulting firm, or firms, will work closely with the Project Manager from the coal company's Environmental or Engineering Department to implement the scope of work, review progress and monitor costs.

4. Implementation

Implementation of these studies will include as a minimum:

(1) Environmental Baseline Studies

(2) Socio-Economic Studies

(3) Archaeological Studies

(4) Environmental Analysis and mitigation

5. Environmental Report

The end product at this stage of investigation is a series of environmental reports, which are submitted to the various regulatory agencies as part of applications for permits or approvals which must be obtained. These agencies may then be required to respond to the National Environmental Policy Act, a subject to be discussed later in the testimony.

6. Environmental Monitoring

Once the reports have been completed and submitted with the applications, the level of environmental studies is reduced to that necessary for the monitoring and continuation of data gathering during the agency review and permitting process. When the mine is in operation, environmental monitoring will continue to make certain that the predictions from the reports are fulfilled, that all necessary mitigating measures are being taken to minimize any adverse impact on the environment, and that compliance with all environmental regulations is accomplished.

Gathering of the necessary data base, interpretation of that data and preparation of the reports is likely to extend over a period of several years, depending upon the urgency of the project, the rate at which drilling and surface rights are acquired, and many other factors.

IV. PRELIMINARY DESIGN

The individual steps enumerated below are conducted simultaneously with the environmental and related studies:

1. Conceptual Mining Development
2. Mining Systems Design Alternatives
3. Stripping Machine(s) Ordering (If applicable. Depends on manufacturer lead time.)
4. Mining Plan Development

It should be noted that these activities must be conducted along with the market development, as well as the assembly of a mineable coal package. All of these functions are closely interrelated, none of which can be conducted by themselves. As will be noted from the schedule (Fig. 1), close to two years can be consumed in attaining this point in the development of a surface mine in the West.

V. PERMITTING

The 1976 FCLAA require the submittal of a mining plan to the U. S. Geological Survey of the Department of Interior within 3 years after lease issuance. At that point in time, much of the information for a definitive mining plan is not yet available, and the plan is, of necessity, very preliminary. The level of detail requested by USGS is much less than that required by OSM in order to obtain a mining and reclamation plan permit.

The OSM procedures now require that the permit application must be deemed complete before drafting the site-specific Environmental Impact Statement.* Therefore, all permit applications must be completed

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* As a result of procedural changes resulting from FCLAA and SMCRA, the permitting and NEPA processes are reversed in Fig. 1 attached herewith as compared to that shown in the chart attached to Mr. Holsten's testimony.

and submitted before the various regulatory agencies will input into the federal/state EIS.

The number of permits and agencies, both federal and state, involved with coal mining will vary with each mining site. There is no one general rule that applies. A recent experience by the author's company showed that starting a mine in a western state required 37 permits or approvals from a variety of federal, state and county regulatory bodies. Attached Tables 1, 2, and 3 list the agency and the type of permit or approval sought. Note that other types are sometimes required.

The environmental reports prepared by the applicant must be submitted with many of these permit or approval applications. Therefore, appropriate environmental work must be accomplished before preparation of the permit application is complete. It is important that the sequence of permit application submittal be appropriately coordinated as some permits ask for identification of other permits as part of the application requirements.

In this particular illustrative example, five years has been allotted to obtain the permits. The time required to develop applications and receive permits becomes a matter of judgment on the part of the operator. Starting with the date when he must

begin mine construction in order to be ready to commence coal shipments per the contractual schedule, he must make a managerial decision as to the date to commence the permitting process. Sufficient time must be allowed before construction for baseline environmental data acquisition and interpretation, engineering studies to define the mining plan, preparation of the application and any resubmittals required, agency review, public hearings, the EIS process, and final permit issuance. Good judgment will allow additional time in the event any of the foregoing necessitates more time than anticipated.

In some recorded cases, it has taken longer than five years from the time that development of the permit application data began until the time the permit was issued. In some instances, the permitting process becomes so extended, some permits expire and must be renewed before the remainder can be issued.

VI. NEPA PROCESS

An Environmental Impact Statement (EIS) is required for "major federal actions significantly affecting the quality of a human environment" (Ref. NEPA Sec. 102(2)(C)). The steps involved are listed below:

1. Identification of lead agency for EIS.
2. Draft EIS.

3. EIS Review and Comments.
4. EIS Hearing and Record.
5. Federal EIS Review
6. Publication of Final EIS and Filing with EPA.
7. Mining, and/or Reclamation Plan Approval.

Fifteen months is a realistic time for this process. The federal agencies usually require at least nine months to write an Environmental Impact Statement and to issue a draft for public hearings. Six months is allotted for the Notice of Public Hearing, Conduct of the Hearing, Maintaining the Record Open for Additional Comments following the hearing, revisions to the EIS, publication of the Final version, and the waiting period before agency action. Thus, this period of time is an addition that must be incorporated after the various permit applications have been completed.

VII. DESIGN AND CONSTRUCTION

The various steps involved in this portion of the development schedule are:

1. Detail Design and Estimation
2. Material Ordering and Contracting
3. Water Well Development (Water Supply)
4. Access Roads and Site Preparation
5. Railroad Construction
6. Power Supply Installation

7. Facilities and Coal Handling Construction
8. Warehouse Building and Yards
9. Coal Preparation and Loading Facilities Construction
10. Overland Conveyor Construction

Obviously some of these are applicable to a site-specific situation while others are not. The important item is that we are talking about a three and one-half year period which extensively overlaps with the permitting and NEPA processes. Essentially design must be complete at the time the permit application is complete. However, construction cannot commence until all of the permits have been obtained. In some cases, construction permits must first be obtained and an inspection conducted before an operating permit can be issued. These individual permit requirements must be carefully analyzed ahead of time. Failure to do so can result in an unplanned delay, which not only becomes expensive, but also may prevent delivery of coal on schedule.

VIII. MINING & SUPPORT PREPARATION

In addition to some of the support equipment construction performed under the prior step, these additional procedures, which can require eighteen months, must be accomplished in order to commence production:

1. Stripping Machine Erection (if applicable)
2. Loader Erection

3. Community Relations

4. Manpower Recruitment and Training

IX. PRODUCTION BUILD-UP

The initial startup of a mine is normally at a slower rate of production than that to be accomplished when contract terms are fulfilled. Usually the coal produced in the early "debugging" of the system will be that required to be placed in storage at the power plant before initial startup of its operations. The length of production build-up period is dependent upon customer requirements. One and one-half years has been used in the illustration. A diligence requirement of production of 1% of the recoverable reserve of the lease could be met in this period in the illustrative example.

X. FULL PRODUCTION

Full production does not come about abruptly. There is a transition stage from build-up to full production, whereby production rates are increased gradually. Usually the contract terms will specify maximum production to be obtained by a certain date and continue thereafter, with gradual reduction in the later years as the generating station operates fewer hours per year. If the mine is to supply two or more units, full production may not be attained for several years when all of the units being supplied are in use.

SUMMARY

As will be noted from the foregoing material, the process of developing a Western coal mine is complex, and can cover an extended period of time. There are numerous opportunities for time consumption before proceeding to the next step. These can be brought about by governmental regulatory requirements, slower demand for the product by the customer, equipment delivery, construction delays and unforseen complications. As indicated previously, each mine becomes a separate entity unto itself. There is no one fixed process that will satisfy all needs. However, the major steps, as outlined above, are required at some stage in the process.

It will be noted from the attached chart:

- Thirteen or more years can be required from lease issuance to initial production.

- Over fifteen years can be utilized before full production.

ILLUSTRATIVE WESTERN SURFACE MINE DEVELOPMENT SCHEDULE

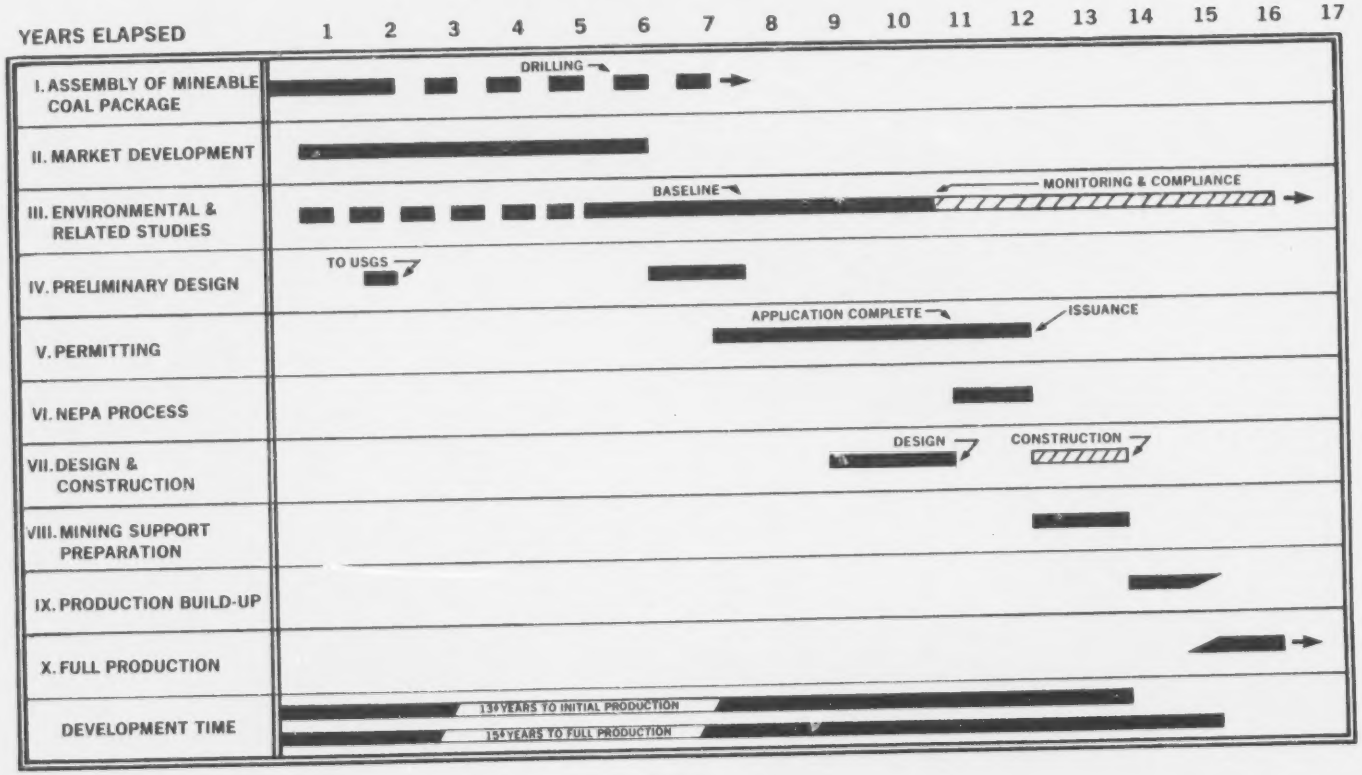

Fig. 1

TABLE 1

FEDERAL PERMITS OR APPROVALS FOR WESTERN COAL MINES

	Type Permit/Approval	Issuing Authority
1.	Mining and Reclamation (SMCRA) Permit	Department of Interior - Office of Surface Mining
2.	Special Use Permit for Access Road	Department of Agriculture - Forest Service
3.	Special Use Permit for Overstripping	Department of Agriculture - Forest Service
4.	Special Use Permit for Railroad Spur	Department of Agriculture - Forest Service
5.	Prevention of Significant Deterioration (PSD) Permit - Air Quality to Construct and Operate	Environmental Protection Agency (EPA) - Region VIII
6.	Exploration	Department of Interior - Geological Survey
7.	Wildlife Permit	Department of Interior - Fish and Wildlife Service
8.	Explosives	Treasury Department - Bureau of Alcohol, Tobacco, and Firearms
9.	Radio License	Federal Communications Commission
10.	Mine Safety Health Administration Permit (MSHA)	Department of Labor - Mine Safety and Health Administration

NOTE: The number of federal permits/approvals can increase under site-specific conditions not encountered in this illustrative example.

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TABLE 2

STATE PERMITS OR APPROVALS FOR WESTERN COAL MINES

	Type Permit/Approval	Issuing Authority
1.	Industrial Siting Permit	Industrial Siting Council
2.	Permit to Mine	Department of Environmental Quality - Land Quality Division
3.	State License to Mine	Department of Environmental Quality - Land Quality Division
4.	Air Quality Permit to Construct	Department of Environmental Quality - Air Quality Division
5.	Approval of Change of Use and Point of Diversion - Inundated Rights	Office of State Engineer
6.	Review of Water Supply and Water Yield Analysis	Office of State Engineer
7.	Permit to Appropriate Groundwater - Plant Site Well	Office of State Engineer
8.	Permit to Appropriate Groundwater - Pit Dewatering	Office of State Engineer
9.	Permit to Discharge Water and Operate (NPDES)	Department of Environmental Quality - Water Quality Division
10.	Permit to Construct Sewage Treatment Facility	Department of Environmental Quality - Water Quality Division
11.	Permit to Construct - Waste Water No. 1 Reservoir	Department of Environmental Quality - Water Quality Division
12.	Permit to Construct - 1A Reservoir, 1B Reservoir, Railroad Loop Reservoir	Department of Environmental Quality - Water Quality Division
13.	Reservoir Permit - Shop Reservoir	Office of State Engineer
14.	Reservoir Permit - Waste Water No. 1 Reservoir	Office of State Engineer

	Type Permit/Approval	Issuing Authority
15.	Reservoir Permit - 1A Reservoir, 1B Reservoir, Railroad Loop Reservoir	Office of State Engineer
16.	Air Quality Permit to Operate	Department of Environmental Quality - Air Quality Division
17.	Approval to Construct a Solid Waste Disposal Site	Department of Environmental Quality - Solid Waste Division
18.	Approval to Operate a Solid Waste Disposal Site	Department of Environmental Quality - Solid Waste Division
19.	Approval of Mining and Reclamation Plan for State Coal Leases	Department of Environmental Quality - Land Quality Division
20.	Scoria Permit	1) Department of Environmental Quality - Land Quality Division 2) Commissioner of Public Lands
21.	Approval to Operate Waste Water No. 1 Reservoir	Department of Environmental Quality - Water Quality Division
22.	Approval to Operate Sewage Treatment Facility	Department of Environmental Quality - Water Quality Division
23.	Sale and Use Tax Permit	Department of Revenue and Taxation
24.	Approval of Spill Prevention Control and Countermeasure Plan	Department of Environmental Quality - Water Quality Division
25.	Notification of Intent to Open a Coal Mine	State Mine Inspector
26.	Informal Approval of Diversion - Creek Diversions	1) Department of Environmental Quality - Water Quality Division 2) Office of State Engineer

NOTE: Each state has its own procedures which could alter the above list of permits or approvals and the name of the agency issuing same, requiring additional or fewer permits/approvals.

TABLE 3

COUNTY PERMITS OR APPROVALS FOR WESTERN COAL MINES

Type Permit/Approval	Issuing Authority
1. Fertilizer and Pest Control	County Commissioner

NOTE: Usually additional county permits/approvals are required for such things as zoning, road crossings, road relocation, sewage and trash disposal, and building codes.

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Federal Coal Leasing Policy

Competition in the Energy Industries

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Preface

Federal, state, and local regulations on the production, distribution, and use of energy resources increased so much during the 1970s that only a few specialists in the field can assess their full scope. Although the regulations that affect the production, distribution, and use of coal match the severity of regulations affecting other fuels, the stringency of coal regulations has attracted inadequate attention. This paper focuses on a particularly little known aspect of federal policy on coal production, namely, federal policy on the leasing of federally owned land containing coal deposits.

The views expressed in this paper are based both on a review of the literature cited in the bibliography and on the author's activities over several years pertaining to the economics of coal production, distribution, and use. These activities have included appraisals of coal supply models for the Electric Power Research Institute (EPRI), assistance of the Management Analysis Center, Inc., in the preparation of a report for a client that was objecting to the proposed Department of Justice guidelines, and participation in a symposium sponsored by the Department of the Interior on a definition of the fair market value of federally owned coal. In addition, the author visited coal producers around the country in the spring of 1980 to develop better models of the coal-supply process for EPRI. This manuscript was completed in the fall of 1980 and does not consider 1981 developments.

The assistance of Exxon U.S.A. in furthering this research and the aid of John Boatwright, its coordinator of economics, in particular, are gratefully acknowledged. The views expressed here, however, are the author's, and they do not necessarily correspond with those of other analysts of federal energy policy and regulations, including the organizations for whom I consulted. My secretary, Mrs. T. Fleming, as usual did an excellent job with the typing. The Center for Energy Policy Research at the Massachusetts Institute of Technology, where I am spending the 1980–1981 academic year, was extremely helpful in assisting the completion of the editorial work.

1
Introduction

The federal government owns a substantial portion of this country's coal resources, especially those west of the Mississippi River. The exact amount of total or federally owned resources is not known, however. The 1979 *Final Environmental Statement, Federal Coal Management Program* issued by the Department of the Interior's Bureau of Land Management indicates that federal coal resources are concentrated in Colorado, Montana, New Mexico, North Dakota, Utah, and Wyoming.[1] It is estimated that federal holdings constitute 72 percent of the coal reserves in these states. Since these states account for about 47 percent of the country's demonstrated coal reserves and about 88 percent of the western reserves, the respective federal shares are 34 percent and 62 percent.[2]

Federal ownership of coal, however, is complicated by several special circumstances. In the past the federal government made outright grants to western railroads of land adjacent to the land used for railroad rights of way, and much of this land is still in private hands. Moreover, these grants to railroads had the peculiarity of ceding only part of the land near rights of way to the railroads while the federal government retained the rest. Furthermore, the federal government has in many cases sold the surface rights to land in the West while retaining the mineral rights. In addition, a portion of the coal-bearing lands of the West is held by other private parties, by Indian tribes, or by state governments. This intermingling of landownership makes the exploitation of western coal reserves more difficult, since a parcel of land must be of an adequate size ("a logical

[1] U.S. Bureau of Land Management, *Final Environmental Statement, Federal Coal Management Program*, 1979, p. 2–1.

[2] Ibid., pp. 2–4, 2–5.

mining unit") if mining is to be carried out efficiently. Hence, parcels of land—or mining rights—must be secured from different owners to provide a land tract of optimum size. This means, in turn, that much of the nation's coal, particularly in the West, cannot be exploited unless private producers are granted access to the coal in federal ownership.[3]

In managing its substantial coal resources, the federal government has emphasized limiting economic rents (that is, the profits resulting from appreciation in the value of mineral properties) and preventing environmental damage. Indeed, the federal government has virtually stopped its leasing of land for coal production while developing stricter rules for mining on its lands, should leasing resume.

The present study contends that current federal policy should be changed and that it is preferable to lease as much federal land as possible for the production of coal. The primary basis of this argument is that fears of excessive economic rents are unjustified. Such fears reflect governmental concern about the development of energy monopoly. Extensive governmental and private analysis of allegations of a developing energy monopoly actually have greatly weakened the contention that anticompetitive behavior is widespread. The studies have indeed concluded that competition is vigorous.

A secondary governmental concern about private markets is that speculators will be excessively rewarded unless the government intervenes. It is argued here, however, that undue weight is being attached to this view and that too little attention is being paid to the socially valuable service provided by speculators.

Moreover, the government has been inadequately aware of its substantial abilities to eliminate economic rents. Through competitive leasing of coal lands, taxation imposed after coal mines have been developed, or a combination of the two, the federal government has the ability to capture the rents.

The government's preoccupation with limiting profits initially was expressed by a moratorium on the granting of new leases, which has been in effect since 1971. In addition, Congress passed the Coal Leasing Amendments Act of 1976 in part, ostensibly, for the purpose of promoting competition. The act involves such matters as how much coal land a company may lease and the speed at which the leases must be developed and requires assurance that the federal government will receive a "fair market value" (presumably meaning all of the economic rent) for its leases. Other provisions of the act are designed

[3] Scott L. Parker et al., *An Analysis of Aspects of the Department of Justice's May 1978 Report on "Competition in the Coal Industry"* (Washington, D.C.: Management Analysis Center, 1979), pp. 36–37.

to ensure efficient recovery of coal, to protect the rights of people who own the surface rights of coal-bearing lands, and to require that the Department of Justice actively promote competition in the coal industry.

It is argued here that most of these legislative provisions are unwise in principle and have been inappropriately applied in practice. Special emphasis is placed on the Justice Department's interpretation of its proper role. It is suggested that the true monopoly problem is that, probably inadvertently, the cumulative effect of government policy has been the development of a de facto governmental monopoly over coal (and oil and gas). Thus, the critical reform at this point is to reduce government monopoly by the resumption of extensive leasing and the removal of some of the legislative restrictions, or at least a more sensible interpretation of these laws by executive agencies.

The Justice Department has taken a dubious approach in appraising the competitive impact of leasing. The department's proposed guidelines on leasing constitute the conclusion to a report that evaluates competition in the coal industry. This analysis suggests that even if one defines the geographic scope of coal markets as narrowly as is reasonable, no evidence exists that severe anticompetitive pressures prevail. Nonetheless, the department then presents rigid guidelines designed to limit market shares. Moreover, the shares are related to the narrow markets as they were defined to permit a conservative estimate of the extent of competition. In short, an analytic device that would actually strengthen the case against federal intervention is employed to support guidelines that implicitly assume that strict controls are needed.

Appropriate guidelines are difficult to devise under any circumstances. The relevant market is usually hard to define, and no theoretic or empirical basis exists for defining critical shares. Furthermore, the Justice Department's guidelines introduced special problems. The department's chief concern was the share of total reserves that could be, but had not yet been, committed to buyers. Formidable measurement problems exist in determining both the amount of reserves that would be available to any firm and the total amount that would be available in each market. Coal holdings may be quite different from marketable reserves, and the degree of commitment to developing these reserves may be difficult to ascertain.

The preferable approach to ensuring competition would be to alter leasing policy to make considerably more coal available for development. If the government insists on constraining competition by limiting the leasing of coal lands, it may become necessary for the Justice Department to act to prevent those who hold the leases from

attaining a monopoly position. In terms of economic principles as well as common sense, no reason exists to assume that guidance should consist of mechanistic formulas of the kind proposed by the department. The logical implication of the analysis, reviewed below, by the Justice Department, the Federal Trade Commission, and the General Accounting Office is that only limited attention to preventing private monopoly is necessary. The guidelines, however, hardly meet that description. If explicit guidelines need to be formulated, the Justice Department ought to consider less stringent ones. The analysis undertaken here, however, suggests that it is unlikely that sensible rules can be devised.

It is also argued here that the environmental policies that have been applied to the mining of coal on federal lands tend to be more cumbersome than necessary to attain given goals. The validity of some of the goals themselves is also questioned.

2

Coal Leasing: Goals and the Participants in Policy Making

Economists recognize that private markets have defects, such as an inherent inability to solve environmental problems, that sometimes justify government intervention in those markets. Many observers of our current environmental policies, however, now suggest that financial incentives—such as the imposition of emission-based taxes on polluters—may be preferable to the regulation that has been adopted by the federal government.

Economists also recognize a widespread tendency to disparage the market for being too effective and thus damaging a particular interest group—particularly one business interest harmed by another. Thus, government regulation must strike a balance between control over imperfections and the prevention of unneeded intervention.

For many years the latter concern dominated energy economics. Before 1970 economists saw the key problem as undue governmental concern for small firms in the extraction of oil, natural gas, and coal and in the refining of petroleum. Since then, however, the government's emphasis has been on restraining the activities of the large oil companies.

Energy economists tend to oppose most existing restrictions on the energy industries except for environmental controls and federal efforts to offset the impact of any disruption in the supply of imported oil. A wide range of views prevails on these two issues. Some leading energy economists are quite supportive of environmental controls, while others believe that existing regulatory policies need considerable reform.[1]

[1] Robert Stobaugh and Daniel Yergin, eds., *Energy Future* (New York: Random House, 1979), present a discussion generally sympathetic to environmental controls. Hans H. Landsberg et al., *Energy: The Next Twenty Years* (Cambridge, Mass.: Ballinger, 1979), is severely critical of existing environmental policies.

The basic objection to many environmental policies is that the government attempts to impose much too specific control on an industry. The regulators assume that they have a much better knowledge of the inner workings of an industry than they possess or are ever likely to attain. Thus, instituting appropriate financial pressures to attain environmental goals would allow private firms, with their superior knowledge of the costs of alternative compliance strategies, to find the cheapest ways to reduce environmental damage. The regulator's problem then becomes one of determining whether the financial pressure is sufficient. By making the potential savings high enough for firms that comply, the regulator can then ensure the attainment of environmental goals.

Economists stress the point that profit-seeking behavior can produce important social benefits. Economists also emphasize that it is possible to overdo anything, including the pursuit of health, safety, or environmental protection. If too much is spent in pursuing these goals, too little may be left for other goals, such as alleviating poverty or reducing unemployment.

The Goals of Federal Energy Policy

The chief stated goals of federal energy policy long have been (1) to promote the efficient production of energy resources, (2) to prevent excessive profits from accruing to the producers, and (3) to protect the environment and public health and safety. The achievement of these goals became more problematic in the 1970s, however, because of an apparent search for certainty. Policy makers today often purport to demand from technical experts the assurance that laws and regulations pertaining to energy policy will infallibly achieve these three goals, and they claim to assume that such assurances can be provided through complex mathematical analyses performed by computers. It is an elementary principle of logic, however, that such analyses only trace the consequences of the assumptions on which they are based. Every builder of the mathematical models used in these analyses is aware that his model contains many ill-verified assumptions. Hence, perfect forecasts of the effects of policy decisions are unattainable.

In some cases the request for assurance may be a way to prevent action, that is, by arguing that in view of the inherently inconclusive nature of forecasts, we do now know enough to take action. Conversely, if action is strongly desired, the defects of the model will be overlooked, and the results of the calculations using the model will be cited as conclusive evidence that a particular policy will prove

beneficial. Thus, requests for assurance frequently appear to be more a part of political maneuvering than honest pleas for guidance.

The conflicts among energy production, profit restriction, and environmental protection are more familiar, and the implications are more obvious. Environmental regulations, for example, should discourage coal production whose costs, including those of environmental damage, exceed the market price that can be obtained for the coal.

In principle, no conflict need exist between profit limitation and efficient production. It is a standard proposition of the economics of taxation that a tax or charge levied on so-called excess profits (that is, those greater than needed to attract resources into an industry) or economic rents will have no effect on output.[2] The basic problem is that most of the actual methods of limiting profits fail to capture the rents and manage to discourage output.

The argument for taxes on economic rents is virtually a tautology. Those who offer goods or services for sale have a minimum price at which they will sell a given quantity of those goods or services. If the offerers receive at least that price, they will provide the given quantity. A rent, then, is the difference between what is paid and what the sellers would have settled for to provide the given quantity. A rent is unrequired payment and thus can be safely taxed.

Since we rarely can know the true required price, however, we cannot tell how much income is excess income. For example, the elaborate efforts of financial analysts to figure out the true cost of capital have proved to be quite imperfect. Accountants refuse to attempt to subdivide profit, as they define it, between required repayments to investors and rents earned. The deficiencies of the efforts of financial analysts to develop a satisfactory method of isolating the rent component of accounting profits suggest that policy makers do not have the tools to measure economic rents accurately and tax them only.

The problem is exacerbated by the tendency to use methods of taxation that are known to interfere with efficient production. Almost invariably, a charge on the percentage of gross income is imposed (for example, a sales tax, a royalty, or the tax on U.S. oil production levied on the difference between allowable and actual prices but misleadingly called an excess profits tax). Such taxes must be paid whether or not excess profits are really earned. They therefore dis-

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[2] Richard A. Musgrave, *The Theory of Public Finance* (New York: McGraw-Hill, 1959), pp. 277–78.

courage production when the tax reduces income below the amount necessary to repay costs.

A nondistortionary method of taxation does in fact exist. Firms know what their true costs are and can make an offer to purchase mineral rights for a lump-sum payment that just allows recovery of all costs. Vigorous competition for mineral rights would guarantee that the offers would be raised to levels that would eliminate economic rents. Extensive studies of oil and gas leasing have consistently shown that this theoretically predicted result does occur in practice.[3]

Fears abound in some quarters that comparable competition does not exist in the coal industry and that the bids accepted for leases would be less successful in capturing economic rents. These fears seem inappropriate, however, since several government and private studies have concluded that the coal industry is highly competitive.[4] The entry of a wide variety of oil companies, electric utilities, established coal-mining companies, construction companies, and others into the market for western coal rights has made the competition vigorous. There would probably be even more competitors seeking entry were it not for the inability to operate profitably all the capacity now in existence. Despite the overall lack of growth in eastern coal mining, newcomers have arisen there, too.

Another key aspect of energy policy making in the 1970s, however, was to reduce reliance on the nondistortionary method of rent capture cited above—lump-sum payments for mining rights. Another major objective has been to limit the role of larger companies—particularly the major oil companies.[5]

The Role of Speculation

One concern frequently expressed about coal leasing is that too much leased land containing coal will be held for speculative purposes. Speculators consist of all those who hold resources for future use. Some speculators expect to produce the resources themselves, while others intend to resell the rights when conditions are appropriate. In

[3] See Walter Mead et al., *Competition and Performance in OCS Oil and Gas Lease Sales and Lease Development, 1954–1969* (Reston, Va.: U.S. Geological Survey, 1980).

[4] The government studies are discussed below, in chapter 5. The principal private study is Thomas D. Duchesneau, *Competition in the U.S. Energy Industry* (Cambridge, Mass.: Ballinger, 1975).

[5] See Stephen L. McDonald, *The Leasing of Federal Lands for Fossil Fuels Production* (Baltimore: Johns Hopkins University Press for Resources for the Future, 1979), for a review of leasing policy that includes extensive review of the trend toward use of more distortionary methods of charging.

many discussions of coal leasing, oddly enough, producer holdings have been more vigorously attacked. Given the alleged desire to encourage production, critics of speculation might logically consider even less desirable those speculators who plan to resell their holdings.

The role of speculators who hold coal-bearing land for resale actually is to provide a special expertise that is not efficiently provided by firms that specialize in production. Land speculators amass an intimate knowledge of the availability of land in a particular area and thus a superior ability to assess how best to assemble parcels of land that can be mined or otherwise efficiently employed. Given the scattered landholding noted at the start of this study, speculators may be essential to the efficient aggregation of coal properties into parcels that can be efficiently mined. Speculators also provide additional competition for leases.

Speculation generally contributes to more efficient production. The role of speculation is to overcome the problems that limit the development of production. The speculator has cleared many of the administrative barriers well in advance of production and makes it easier to respond to demands as they arise, since what is needed is land parcels on which mines can be quickly developed. Clearly, then, the greater the administrative barriers to resource acquisition and development, the more speculation is desirable.

But federal coal policy, in its insistence upon increasing the administrative barriers to securing and putting a lease into operation, also makes it more difficult to hold leases. These actions combine to reduce the ability of producers to produce coal. No sensible justification exists for such restrictions. Given the limits (which are outlined below) on the holdings of any one firm, the addition of limits on total industry holdings is unnecessary and may even be anticompetitive. Limits on the holdings of individual firms should suffice to create numerous firms, none of which can control prices.

As far as economic efficiency is concerned, leasing can be inadequate but never deficient. If a company leases land where the exploitation of coal resources is not presently competitive, no harm results because the land will simply not be mined (unless the government adds, as it has, pressure to mine the land prematurely). But a failure to lease coal resources whose mining would have been profitable irreversibly raises costs.

The problem of environmental protection does not by itself affect this conclusion. If good environmental policies exist, the decision of leaseholders on whether to begin exploitation will involve a consideration of environmental costs, and production that should be prevented for environmental reasons will be prevented. Similarly, the level of

leasing, for reasons discussed below, should not greatly affect the transfer of economic rents to the government.

The effect of governmental limits on leasing is exacerbated by the forecasting burden it places on government. It becomes necessary for the government to determine which reserves will be needed and when. It is doubtful that the federal government both could and would assemble the data that would be needed for such predictions. Limited leasing is likely to be particularly inappropriate for the 1980s, since conditions in the energy market are likely to remain highly unsettled and subject to continued disturbances (including further governmental changes in the ground rules). Thus, limiting leasing to what the government determines to be "requirements" is infeasible as well as undesirable. The process assigns more decision-making authority to public policy makers than they can manage.

The market appears to be better at determining the optimum pattern of development of coal supply than any conceivable governmental decision-making process. Experience shows that Congress is rarely willing to appropriate the funds necessary for the types of extensive analysis that would be required to determine the best constraints on leasing.

Given that the federal government is so substantial a landowner, it possesses substantial monopoly power that should be restrained. Federal limitations on leasing can prove to abet use of that monopoly power. The government's authority to limit leasing can be used to justify the sale of less coal than would be desirable from the viewpoint of economic efficiency. In particular, the government can keep off the market coal resources that should be developed because their cost, including environmental damage, is less than the price at which they can be sold. This restriction on supply will then raise the price of coal and, in turn, what bidders will be willing to pay for leases. In this way the government can both create and capture substantial monopoly profits. The effort to prevent excess gains by private individuals or firms threatens to lead to much larger excess gains by the only well-identified possessor of true monopoly power in coal, namely, the federal government.

If the goal is to ensure the vigor of competition, there can never be too many owners of mineral rights. Overzealous efforts to curtail the total amount of leasing may not only reduce the availability of coal but also give part of the government's monopoly power to a restricted group of leaseholders. Competitive bidding will ensure that adequate payments will be made, and this process should not be materially affected by the possibility that not all of the leases will be

exploited immediately. A well-functioning market will ensure that the bids are properly adjusted to take account of this uncertainty.

The concept of a well-functioning market includes the belief that a profitable investment can always be financed. Those familiar with the literature on investment behavior know that some theorists allege that methods of pooling risks among a variety of institutions are inadequate to command enough investment in highly risky alternatives. But financial institutions have shown considerable ingenuity in devising new techniques to meet new needs. What seems to bother some theorists is that, contrary to their theories, actual institutions do not provide all the necessary risk-pooling devices. The real defect seems to lie in the theories, which assume that the creation of such devices is costless. Financial institutions cost money to operate, and the financial community stops short of providing complete risk pooling because the additional cost would be more than the likely benefit. Thus, this theoretical criticism of capital markets seems misplaced.

It is true, of course, that the government would receive less gross income under rapid leasing than it would if it delayed leasing. This would not be a loss, however, but merely a reflection of the fact that money earns interest. The purchase of a lease before exploitation means that the purchaser surrenders money and therefore forgoes interest on it. Conversely, the government gains the opportunity to earn interest during the period between the sale and exploitation. The lower price for an earlier purchase should exactly equal the interest forgone by the government. The government's ability to earn interest means that, if it reinvested the income for the sale of a lease whenever leasing occurred, it would end up with exactly the same gross income at the time mining starts.[6] At that time, the initial payment plus accrued interest would be identical and equal to the present value of the economic rents.

Another way to ensure the capture of economic rents would be to impose additional taxes once the total rents were known. To be sure, these taxes would distort production to a greater extent than lump-sum payments would. In the 1970s, however, Congress showed little concern about imposing highly distortionary taxes.

In sum, so-called excess leaseholding proves, on close examination, to be a virtue. No marked social harm can result from leasing coal lands well before their actual development. Furthermore, the failure to lease the best land means that inferior coal land will be mined. Public policies designed to restrict either the total amount of land

[6] Ibid., p. 89, presents a contrary view on the issue of limited leasing and a citation of a communication from Walter Mead supporting my position.

under lease or the period for which the land may be leased are therefore ill advised. Moreover, government lacks the ability to develop the accurate forecasts needed to make limited leasing work satisfactorily.

Any special action directed at speculative holdings of land by middlemen is equally ill advised. The widespread prejudice against such speculators is due in large measure to complaints by other businesses that speculation destabilizes markets, which probably means in the case of federal land leasing and most other situations that speculation makes markets more competitive.

Protecting the Rights of Surface Owners

Protection of the owners of surface rights to mineral lands is a justifiable public concern. Appropriate protective devices are quite difficult to devise, however, particularly in the context of restrictive leasing policies. A badly designed program would allow the owners of surface rights to preempt governmental collection of economic rents. As noted, competitive, well-informed bidders for mineral rights are willing to pay an amount up to the present value of the economic rents for access to mineral rights. If the law allows surface owners to sell before the government, the surface owners can capture the rents. This, of course, would undermine the principle that the government should receive the rents. Reliance on postlease negotiations with surface owners could prevent this but still could, under inappropriate institutional arrangement, give the surface owners a degree of monopoly power.

Dangers like these are also aggravated by a policy of limited leasing. If leasing is extensive, each landowner is simply one of many possible suppliers of land, and competitive market forces will lead to the appropriate sale price, namely, the value of the land for whatever its most profitable alternative use may be. In recognition of the problem of rent capture by surface landowners, the Interior Department has proposed to limit what owners of surface rights may charge for those rights.

This review indicates that the desire to limit the total number and duration of leases of federal coal lands to private interests is likely to harm competition, may impede the expeditious development of energy resources, and will not contribute much, if anything, to capturing economic rents.[7]

[7] Whether existing requirements for the reclamation of surface mines benefit or harm the public interest remains controversial and is, in any event, not central to the concerns expressed here.

The Participants in the Debates on Leasing Policy

Federal policies affecting coal production and use have emerged from an elaborate but largely uncoordinated process of interaction among government agencies, Congress, lobbyists for energy interests, environmental groups, and organized critics of the energy industries.[8] Three basic points should be made about this process. First, the resulting institutional framework is quite complex, probably unnecessarily so.[9] Second, none of the interested groups is monolithic. Third, no warrant exists for considering any of these groups more selfless than the others.

The rifts within the various interested groups are considerable, but they are probably most obvious in the case of the producers. Some of the independent coal companies complain privately about the entry of oil companies and other types of business firms into the industry, while eastern coal interests seek to restrain competition from western coal interests. At least some electric utilities (most notably the Tennessee Valley Authority) have joined the attack on energy monopolies.[10]

The critical concern here, however, is not that these different groups exist and have had various degrees of success in influencing policy making. What is more important here is an understanding of the wide variety of federal agencies that directly or indirectly affect coal leasing. Attention must be given both to the agencies that control coal supply and to those that affect the level and composition of coal demand. In ways that are difficult to predict, the agencies that affect demand thus alter the amount of federal coal that can be exploited.

As coal-leasing policy evolved in the 1970s, a wide variety of federal participants became involved, making use of both long-established legislation and new laws. The Department of the Interior remains the focal point for most of the critical decisions, but authority within the department has become increasingly dispersed. The department's Bureau of Land Management and the U.S. Geological Survey continue to hold their longstanding responsibilities to implement

[8] The term "organized critics" refers to so-called consumer groups. I believe these groups are poor representatives of consumers, but no neutral term to identify them is in general circulation.

[9] See Landsberg, *Energy*, passim, esp. chap. 14; and Daniel M. Ogden, Jr., "Protecting Energy Turf: The Department of Energy Organization Act," *Natural Resources Journal*, vol. 18 (October 1978), pp. 845–57.

[10] See U.S. Tennessee Valley Authority, *The Structure of the Energy Markets: A Report of TVA's Antitrust Investigation of the Coal and Uranium Industries* (Knoxville, 1977), and *The Structure of the Energy Markets: A Report of TVA's Antitrust Investigation of the Coal and Uranium Industries, 1979 Update* (Knoxville, 1979).

policy. Leasing is primarily a function of the Bureau of Land Management, while the Geological Survey has the major authority to appraise resources. The Office of Surface Mining, created in 1977, has responsibility for regulating strip mining, including the mining of coal that is federally owned. Meanwhile, the Bureau of Indian Affairs has become more assertive in helping Indian tribes to obtain better contracts for coal on tribal lands and to renegotiate earlier contracts now alleged to be unsatisfactory. The proliferation of Interior Department obligations, moreover, has led to the creation of several ad hoc task forces.

Furthermore, the secretary of the interior and his assistants were compelled to devote considerable attention during the 1970s to leasing questions.[11]

Other government agencies that have become directly involved in leasing policy include the Department of Energy, which is charged with setting the basic goals of the leasing program, and the Department of Justice, which has proposed guidelines to ensure that current leasing procedures avoid anticompetitive effects. Important indirect influences include the Environmental Protection Agency, which establishes rules governing the burning of coal, and the Interstate Commerce Commission and the Department of Transportation, whose regulations affect the costs of transporting coal.

Congress has been involved in leasing policy by enacting the legislation that created new responsibilities for the agencies mentioned. The implementation of many of these laws has been challenged in the federal courts by such groups as the Sierra Club and the National Resources Defense Council, and as a result the courts have also become a factor in leasing policy.

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[11] The longstanding DOI responsibility to regulate coal-mining operations to protect the health and the safety of miners was transferred to the Department of Labor in 1978.

3

An Examination of Major Decisions Affecting Coal Leasing

In 1971 Interior Secretary Rogers C. B. Morton imposed a moratorium on the leasing of federal land for the mining of coal. Subsequent efforts of the Department of the Interior to lift the moratorium have been hampered by various laws enacted by Congress, most of them for the purpose of protecting the environment.

The moratorium limited the issuance of leases to those necessary to the continued operation of existing mines. As of early 1981 a resumption of full-scale leasing was scheduled for later in 1981. The Reagan administration appears eager to speed leasing.

The moratorium has been rationalized somewhat differently in various reviews of the matter. For example, the Department of the Interior's *Final Environmental Statement, Federal Coal Management Program* traces the moratorium to a 1970 report by the Bureau of Land Management surveying the history of leasing.[1] The survey showed a sharp increase (from 80,000 to 788,000 acres) in the amount of land under lease in 1970 as compared with 1945, but it also showed a decline in coal production on these lands. The Department of Interior therefore concluded that further leasing could be safely delayed, and a similar argument was made in a 1974 report by a private group called the Council on Economic Priorities. In 1978 the Department of Justice issued a report on competition in the coal industry that cited the Interior Department's reason for the moratorium but placed more emphasis on assertions also made in the report by the Council on Economic Priorities that too little had been charged for the leases.[2]

These views now seem curious. Leasing occurs for the purpose of

[1] See U.S. Bureau of Land Management, *Final Environmental Statement, Federal Coal Management Program*, 1979, pp. 1–9.

[2] See U.S. Department of Justice, *Competition in the Coal Industry*, 1978, p. 3.

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satisfying anticipated future demands for coal, and what was important was the prospect of an expansion of demand. The possibility that demand would, in fact, increase was clearly observable at the time the moratorium was imposed. Commonwealth Edison and other midwestern utilities had started using low-sulfur western coal, and concern was rising among the utilities that stack-gas scrubbers to remove sulfur dioxide from the air emissions of plants using high-sulfur coal would cost more than increased use of western coal. The signs of a growing demand for western coal, of course, have become more widely evident since then.

The laws that have significantly influenced federal leasing policy include the National Environmental Policy Act (NEPA) of 1969, the Coal Leasing Amendments Act of 1976, the Surface Mining Control and Reclamation Act of 1977, the Clean Air Act Amendments of 1977, and the Department of Energy Act of 1977.

The key element of the NEPA was the requirement that all major federal actions be accompanied by environmental impact statements to show that the programs would be conducted in compliance with federal environmental goals. In practice, however, requiring environmental impact statements has been an effective way of preventing rapid action and an ineffective way of promoting environmental improvement.

The basic problem is that the NEPA substitutes formalistic review by unqualified observers for substantive control by appropriate authorities. The courts have developed an elaborate set of guidelines about what constitutes an adequate environmental impact statement, but there is little evidence that these guidelines ensure proper action. Indeed, the guidelines seem to have headed the impact statement process and the application of environmental rules to governmental actions in the worst possible direction.

As interpreted by the courts, the NEPA requires each agency to determine which alternative decision in any particular case would be environmentally preferable. Under these guidelines, every agency must pretend to have the competence to appraise a wide variety of alternatives. Every decision relating to a specific type of energy, for example, must include a determination of whether some other source of energy would be a better choice.

The minimum complaint about this process is that it is almost certain to be ill performed. It is quite unlikely that funds will be appropriated to permit the acquisition of sufficient expertise to permit an adequate appraisal.

More fundamental problems exist, however. In terms of efficient and consistent administration, it is undesirable to make each agency

an independent judge of what is environmentally appropriate. Federal agencies ought to be subject to the same sorts of pressure that ideally would be applied to private parties. Federal regulatory bodies would set up well-defined environmental goals and develop effective methods of ensuring compliance. The rule-making agencies, in their turn, ought to have well-defined congressional mandates to guide their decisions. Such mandates would make environmental impact statements unnecessary.

It now appears that with sufficient diligence any aggrieved party can find a judge willing to find flaws in any given environmental impact statement. Some statements go unchallenged while others are successfully blocked. Thus, in 1977 a federal court held that the Interior Department's environmental impact statement on the proposed resumption of coal leasing failed to consider adequately the alternative of no leasing. The court decision appeared illogical, since the department's statement only sought permission to consider what might constitute the optimal level of leasing. Since nonleasing is simply setting the optimum level at zero, the search for an optimum implicitly involved a consideration of nonleasing. The decision might have been overturned through an appeal to a higher court, but the department chose not to make such an appeal. Cases like this suggest, therefore, that the NEPA should be replaced by the approach outlined above.

Another important influence on leasing policy is the Coal Leasing Amendments Act of 1976. The amendments combined federal offers of additional funds to coal-mining states with the imposition of a variety of restrictions on the terms of leaseholdings. One of these restrictions was that a 12.5 percent royalty had to be one element of the payments leaseholders made to the federal government. The fresh grant to the states then was half that royalty income. Presumably this provision was added to make the bill more appealing to mining state members of Congress. (Another 40 percent of royalty income has traditionally been earmarked for federal projects in the states where federal lands are leased and mined.)

The restrictions include rules on the terms of leasing and the amounts of land that individuals can hold, upper limits on the period between the granting of a lease and the start of coal production, and rules on mine operation. The leasing policy restrictions include the suggestion that efforts should be made by the Bureau of Land Management to ensure that any given tract of land is large enough to support an economically efficient mine (but does not exceed 25,000 acres). At least half of the leases must be granted under a system in which the buyer can defer paying the lump sum ordinarily required

as part of the compensation to the government. The amendments also include a provision that requires the setting-aside of some leases for small businesses and public bodies. Under the newly amended law, the government was expected to receive fair market value for all of the coal found on the leased land. Fair market value was undefined in the act but apparently was to be interpreted as meaning the full capture of economic rents.

The legislation limits a firm to 40,000 acres per state and 100,000 acres nationally and precludes leasing to firms that have not started producing coal from land previously leased. Exploitation must begin within ten years of the granting of the lease, and reserves may not exceed the amount that could be produced within forty years. Other provisions of the act, discussed below, required the Interior Department to estimate the most desirable production rate for the property. The department subsequently indicated that holders of coal rights previously leased but not put into production by June 1, 1986, could lose their leases. Firms were required to maximize the recovery of coal, and the Department of Justice was given the task of monitoring the effect of leasing policy on competition among coal producers through both an annual report on the status of competition and assessments of whether given leases "would create or maintain a situation inconsistent with the antitrust laws." (The monitoring of competition is discussed at greater length in chapter 4.)

Other provisions effectively shifted the responsibility for exploration to the federal government. Although exploration permits could be secured by private parties, there was no assurance that land that proved to contain coal deposits could be leased. Meanwhile, a resource appraisal program was to be instituted by the Geological Survey.

Due Diligence, Fair Market Value, and Maximum Economic Recovery

Further comments on due diligence (that is, the requirements for rapid development and limited lives for leases) and examination of the concepts of fair market value, maximum economic recovery, and similar requirements of the act are in order at this point.

It was argued above that no threat is posed either to economic efficiency or to the capture of excess profits by allowing leased land to stand unutilized. Conversely, however, restrictions on how long the leased land may be left idle and on the length of the production period can interfere with efficient use.

Due diligence, fair market value, and maximum economic recovery share the basic characteristic that they are innocuous only

when they are irrelevant to private decision making. No harm would be done by requirements of due diligence if optimum exploitation complied with the rules or if a particular lease was not worth exploiting. But if the most efficient extraction schedule came into conflict with the requirements of due diligence, harm would occur. Two outcomes are possible when the production timetable dictated by due diligence is inefficient. If the inefficiency is great enough, it will not be profitable to operate a mine, and the coal will not be available at the appropriate time unless the Interior Department has the extraordinary luck to issue a lease again when optimum development complies with the due diligence requirements. If the inefficiency is of a lesser degree, the leased land will be mined but with a suboptimal pattern of development. In particular, both excess production and profit reduction will probably occur.[3] Early in 1980 I interviewed the executives of numerous coal producers and found that those with leases in the West were developing them somewhat sooner than they desired simply to preserve the leases.

Fair market value and maximum economic recovery are principles that are satisfied automatically in a competitive market. The case for fair market value was made in the earlier discussion of how economic rents can be captured by competitive leasing. The point about full recovery is even simpler to make: a profit-seeking firm will naturally be motivated to recover all of the coal that can be recovered efficiently.

The best approach would be to assume that both goals will be automatically satisfied by market forces and not adopt specific enforcement procedures. Unfortunately, however, a law creates a presumption that action is needed, and the Interior Department has acted. In the case of maximum economic recovery, the response thus far has been appropriate. The department backed away from forcing producers to use some of their excess profits to subsidize the recovery of more expensive coal and is effectively allowing private firms to extract only the coal that is profitable to produce.[4] There is still the danger, however, that it will try to second-guess private estimates of profitability.

The department has spent some effort on trying to outguess the market in estimating fair market values, however, by developing a computer model with which it hopes to calculate such values and thus reject bids that fail to meet its estimates. For reasons discussed earlier,

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[3] See Stephen L. McDonald, *The Leasing of Federal Lands for Fossil Fuels Production* (Baltimore: Johns Hopkins University Press for Resources for the Future, 1979), p. 89.

[4] See U.S. Department of the Interior, *Secretarial Issue Document: Federal Coal Management Program*, p. 17.

however, there is little reason for the department to put its trust in models.

The deferral of the lump-sum payment in partial compensation for leases was designed to increase the ability of smaller firms to participate in coal production. Presumably such firms can more easily finance several smaller payments than one big one. One might fairly ask whether western mining, where one mine could make its owner one of the top ten or twenty producers nationally, is a business for people so poorly financed that they cannot pay the lump sum immediately. On the other hand, no obvious harm is likely to be produced by the provision, which may provide some incentive for useful experimentation.

The final element of these efforts to alter the allocation of resources to coal that requires review is the suggestion that the Interior Department attempt to consolidate holdings into logical mining units. The concern is whether such efforts would be unnecessary and possibly inefficient because of the superior skill of private speculators.

Other Laws Affecting Leasing

Other laws affecting western coal development have had more indirect effects on leasing policy. The Surface Mine Control and Reclamation Act is important for making surface mining more difficult in several respects. The most familiar, and thus one that can be treated briefly, is that of imposing reclamation requirements. For the purpose of evaluating leasing policy, it suffices to note that the regulations under the act impose restrictions on mining practices that raise costs and thus weaken the competitive position of surface-mined coal. Coal producers have strongly argued that too mechanistic an approach to reclamation—invariably described as a "cookbook" method—has been taken, while environmentalists have expressed some concern about the weakness of the reclamation requirements.

The more interesting provisions are the unsuitability criteria and the surface landowner protection clauses. The unsuitability criteria mandate the elimination of surface mining in critical areas, such as national forests, prime agricultural lands, and alluvial valleys (essentially locations in which water flows occur that are essential to farming). General questions can be raised about the wisdom of so sweeping a set of provisions, and complaints are being heard that the alluvial valley prohibition is being interpreted in such a way that the slightest disruption of water flow is deemed cause for prohibiting mining. The clauses that protect surface landowners provide such owners with

double protection. They can argue for exclusion of their land from exploitation, and they are guaranteed adequate compensation for any land disruption they allow.

The 1977 amendments to the Clean Air Act require the use of the best available control technology and the prevention of significant deterioration in air quality. The latter was the legislative ratification of a judicially created policy. The preamble to the Clean Air Act set preservation of air quality as a goal. Subsequently a federal judge decided this provision meant that it was necessary to limit increases in pollution in areas where air quality was better than that required by federal standards. The Environmental Protection Agency (EPA) proved incapable of implementing so vague a guideline, and Congress therefore included in the 1977 amendments a basis for setting policy to limit increases in pollution.

Just what the effect of the legislation will be remains to be seen. The impression one often gleans from casual discussions is that the legislation was intended to protect areas celebrated for their clean air, such as Arizona and New Mexico. In fact, prevention of significant deterioration (PSD) areas exist throughout the United States. Several eastern utilities have noted in their regular reports to the Securities and Exchange Commission that PSD rules are affecting plant-siting. New power plants and coal mines will compete for a share of the limited increments in pollution allowable with PSD, and their ability to locate in any PSD region will be limited. Disputes may thus arise between the builders of power plants for local use and the operators of mines or power plants in one region that are intended to serve another region.

The rules mandating the use of the best available control technology (BACT) pose a greater threat to western coal development than the creation of PSD areas. Many observers have said that the BACT requirement was largely a political attempt to limit western coal output that has only limited relevance to controlling air pollution.[5] Before 1977 new large coal-burning facilities were subject to rules that required the reduction of sulfur dioxide emissions to 1.20 pounds per million British thermal units (B.t.u.) burned. This stimulated greater demand for low-sulfur western coal and less use of emission cleanup devices than eastern coal interests expected. The BACT requirement was intended to result in the removal of sulfur from coal by precombustion cleaning or the capture of sulfur dioxide

[5] See Hans H. Landsberg et al., *Energy: The Next Twenty Years* (Cambridge, Mass.: Ballinger, 1979), p. 378, for a statement on the political intentions of the BACT requirement by his highly circumspect study group.

emissions by stack-gas scrubbers. Scrubbers, in fact, were expected to be the principal means of compliance, as shown by the EPA's emphasis on scrubber use in its policy studies.

One obvious concern of the EPA's in implementing the 1977 amendments was to guarantee that the new rules would not be less stringent than the old ones. Some types of coal contain so much sulfur that burning them would result in emissions that would systematically exceed the limit of 1.20 pounds of sulfur oxides per million B.t.u., despite the installation of high-performance scrubbers. To keep pollution levels below those required by the old rules, the new rules had to prohibit the burning of high-sulfur coal.

Another EPA concern was whether or not it was appropriate totally to ignore the advantages of using low-sulfur coal. Here the alternatives ranged from granting maximum possible credit for using low-sulfur coal to granting no credit. Full credit would have meant interpreting the BACT requirement as a mandate to tighten the emission limits to, say, 0.80 pounds per million B.t.u. Almost all coal emissions would have to be scrubbed, but the degree of scrubbing would be proportional to the sulfur content. At the other extreme, the emission difference could be ignored in favor of removing an equal percentage of sulfur from all types of coal.

The compromise adopted was that maximum scrubbing could be avoided if emissions were kept below 0.60 pounds. This standard has apparently provided only modest incentives for the scrubbing of low-sulfur coal.[6]

The creation of the Department of Energy produced still another complication in the establishment of coal-leasing policy. The department was only granted authority to establish overall leasing policy, while the Interior Department retained responsibility for administering the actual leasing process. But the border between policy and implementation is ill defined, and there has been friction over the extent to which the Department of Energy can exert its influence over the Interior Department.

One last complication has been the substantial increase in freight rates for coal transported by rail. Some observers suspect that the railroads have adopted a policy by which shippers with few transportation alternatives are being charged monopoly rates, shippers with several alternatives are getting more favorable rates, and excessive

[6] See Richard L. Gordon, *Economic Analysis of Coal Supply: An Assessment of Existing Studies* (Palo Alto: Electric Power Research Institute, 1979), vol. 3, chap. 2. This work relies heavily on reports by ICF, Inc.

rates are being charged to coal shippers to finance unprofitable lines whose abandonment is politically infeasible.[7]

The Results of Recent Federal Decisions

The legislation and administrative procedures discussed above have produced the following results:

First, new coal leasing is unlikely to resume before 1981.

Second, the review and approval procedure is now so long that it is likely to take a private enterprise ten years or more to move from a decision to operate a mine on federal land to the opening of the mine.

Third, the limits on total amounts of land leased and the due diligence provisions are anticompetitive and encourage economic inefficiency, as do current tax policies and the policy on setting aside land for particular groups.

Thus, the federal government—particularly Congress and certain regulatory agencies—has strongly discouraged competition in the coal industry. A true desire for greater competition would lead to the conclusion (a view already reached by the Department of Justice and the General Accounting Office) that if the federal government wants more competition in the coal industry, it should simply lease more federal land containing coal deposits.

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[7] See statement by George H. Borts in *Statements of Facts and Argument of Union Electric Company, Wisconsin Electric Company, Wisconsin Power & Light Company, and Wisconsin Public Service Corporation before the Interstate Commerce Commission, Increased Rates on Coal, Midwestern Railroad, August 1979* (docket 37246 and sub. nos. 1–6 and consolidated cases 37348 and 37353), pp. 4, 8–9.

4

Competition in the Coal Industry and the Department of Justice Guidelines

The guidelines on coal leasing proposed in 1978 by the Department of Justice (DOJ) are based both on the information available on the problem of energy monopoly and on general antitrust analysis and policy. Energy monopoly and antitrust policy are broad topics, and this section is limited to a discussion of the documents most germane to an appraisal of the guidelines. As far as energy monopoly is concerned, this means the DOJ study explaining its leasing guidelines and a Federal Trade Commission study that was a major source of data for the DOJ. A few other studies, including one by the General Accounting Office, are noted. The review of antitrust policy is limited to the principles explicitly stated by the DOJ in establishing its guidelines.

The Prevention of Monopoly

Concern over energy monopoly, of course, has existed ever since the attacks in the late nineteenth century on the Standard Oil trust. Intense consideration of possibly anticompetitive conditions in the energy market emerged again during the late 1960s because of growing instability in the energy markets. Numerous congressional hearings have dealt with alleged monopolies in each of the processes associated with a given fuel (such as extraction or refining), through vertical integration (such as participation in production, refining, and transportation of oil), or through horizontal integration (especially by ownership of more than one source of energy). As a result, various proposals have been made to prohibit vertical integration as well as the production of more than one fuel. Some efforts have also been made to restrict the degree of participation of any one company in

any one activity, and it is prohibitions of this type in the realm of coal, and coal and nuclear energy combined, that are of concern here.

The development of the DOJ guidelines was an attempt to give explicit meaning to an unclear congressional mandate: preventing "a situation inconsistent with the antitrust law."[1] The DOJ has interpreted this to mean that it can apply standards to the coal industry that are stricter than those normally applied in enforcing the antitrust laws. This principle of greater stringency grew out of interpretations of similar powers granted to the DOJ to review the licensing of nuclear power plants. It was decided that a perception of danger could be used to justify action by the department even if no antitrust law was violated.

Just what criteria would be used to determine potential danger is not very clear, since both the decision by the Nuclear Regulatory Commission (NRC) cited as the basis for the principle of greater stringency and the restatement of the decision by the DOJ are cryptic. As the DOJ quoted the NRC, situations "which ran counter to the *policies* underlying the [antitrust laws], even where no actual violation of statute was made clear, would warrant remedial license conditions under [the law authorizing antitrust review of nuclear plants]" (the emphasis and the first bracketed term come from the DOJ report).[2] The DOJ's attempt to explain this runs as follows: "Thus, situations inconsistent with the antitrust laws or counter to the tenets underlying those laws may be prevented from reaching the point where society would suffer from their detrimental effects."[3] This would appear to be an assertion of unlimited power to stop actions in any area to which the inconsistency with antitrust principle applies if there is the slightest suspicion of an anticompetitive threat.

The potential for abuse of this power seems to have been realized in the principles used to develop the DOJ guidelines on the coal industry. Reiterating a familiar point in the antitrust literature, the department's 1978 report states that the prevention of new developments, such as mergers that lessen competition, are subject to stricter enforcement standards involving less conclusive demonstrations of damages than the standards applicable to controlling the monopoly power of existing firms. In 1969 the department attempted to tighten its limits on all types of mergers by devising guidelines on what constituted an allowable merger.

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[1] The phrase apparently was introduced in the antitrust provisions, section 105 a(5) of the Atomic Energy Act, governing nuclear licenses and was incorporated into section 8 of the Coal Leasing Amendments Act of 1976.

[2] See U.S. Department of Justice, *Competition in the Coal Industry*, 1978, p. 3.

[3] Ibid., p. 6.

These 1969 rules take into account the degree of concentration within an industry (that is, the total share of market sales of the four largest firms), the market share of the acquiring firm, and the market share of the acquired firm. Two sets of guidelines were provided. The more stringent set was for industries where concentration was 75 percent or more. The other set was for industries with a lesser concentration. Both sets of guidelines caused the size of allowable acquisitions to decrease as the market share of the acquiring firm became larger. The starting point in highly concentrated industries was that a firm with 4 percent of the market could not acquire a firm with an equal or larger share of the market. If the acquiring firm had a market share of 15 percent or more, it could not buy firms with market shares of 1 percent or more. The scale for less concentrated industries limited acquisitions by firms with a 5 percent share to firms with less than 5 percent; a firm with a 15 percent share could acquire firms with less than a 3 percent share; only when a firm's share reached 25 percent would it be prevented from acquiring firms with shares of 1 percent or more.

Justice combined its 1969 guidelines with its concept of greater stringency in developing its proposed 1978 guidelines for coal leasing. The 1978 guidelines are based on three general principles:

1. No company will be allowed to lease more federal coal if it holds more than 15 percent of the "uncommitted nonfederal reserves" in the relevant market. "Nonfederal" here includes federal coal under lease; the relevant markets, as discussed below, are defined in the DOJ report.
2. A 10 percent limit will be applied to firms also engaged in uranium conversion or fuel-rod fabrication.
3. The existing prohibitions on coal leasing by railroads will be supplemented by a ban on leases to joint ventures that include railroads.

To be sure, the proposed guidelines are hedged by noting that what is being stated is a prima facie case that "creates a rebuttal presumption." Although this apparently means that exceptions to the rules will be made, the department's reply to a letter from the Exxon Corporation in which the company said it thought exceptions would be rare was simply a reiteration that the presumption would be rebuttable.[4]

Despite the Justice Department's action, neither economic theory nor empirical evidence provides a satisfactory basis for setting

[4] Exxon U.S.A. (W. T. Slick), 1979 letter to John H. Shenefield of the U.S. Department of Justice.

mechanical rules for the acquisition of new coal leases by existing firms. The idea that firms should not be allowed to attain too large a market share has often been advocated, but no consensus prevails about how to select the cutoff point actually adopted.[5] Markets are difficult to define unambiguously. The DOJ guidelines do not follow logically from either the department's legal mandate or its analysis of actual problems. After having argued that no serious monopoly problems existed, the department then set up guidelines that are designed to constrain lease grants severely.

The DOJ also erred by requiring the industry to disprove the assumptions underlying the guidelines. These assumptions are hardly so well justified that the burden of proof should rest on the companies; the Justice Department should be the one required to prove harm.

The guidelines are far less stringent, however, than some of the legislation that has been proposed to limit the participation of any one company to one stage in the production and processing of one fuel, as well as proposed bills that would simply ban oil companies from obtaining federal coal leases or uranium claims. An alternative, proposed by Alfred F. Dougherty of the Federal Trade Commission, would be to limit coal holdings by all oil companies to 5 percent of national reserves.[6]

Problems of Appraising Competition

For many years analysts of competition in the U.S. economy have employed "concentration ratios" as indicators of the vigor of competition within an industry. Periodically, efforts are made to establish rules of thumb about what constitutes a degree of concentration indicative of inadequate competition. Sometimes these measures are simply suggested as theoretical exercises, but occasionally proposals (such as those of the DOJ) are made to guide public policy according to such rules of thumb. Such proposals have received scant acclaim. No adequate basis exists for establishing such rules, which involve running roughshod over economic principles.

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[5] See U.S. Federal Trade Commission, *Report to the Federal Trade Commission on the Structure of the Nation's Coal Industry*, 1978, pp. 32–35, for a discussion of the difficulties in determining satisfactory guidelines. The bibliography to this book lists numerous studies that discuss the problem of determining what constitutes an excessive market share. See especially Joe S. Bain, *Industrial Organization*, 2d ed. (New York: John Wiley & Sons, 1968), for a widely cited discussion of market shares; and C. Kaysen and D. F. Turner, *Antitrust Policy* (Cambridge: Harvard University Press, 1959), for one of the earliest proposals to impose limits on market shares.

[6] See Alfred F. Dougherty, Jr., "Statement before the Subcommittee on Energy and the Environment, Committee on the Interior, House of Representatives, on Horizontal Integration of Oil Companies," July 17, 1979.

The fundamental problem is that the concept of guidelines assumes the existence of a clear compartmentalization of the economy, which, as modern economic theory stresses, does not exist. Current economic theory stresses the interrelationship of markets and the impossibility of trying to separate the economy into isolated units. Concentration ratios, in contrast, assume the existence of such strong separation.

The theory of oligopoly stresses the inherent tension between the desire of firms to cooperate (explicitly or tacitly) to restrict competition and the formidable barriers to success in that effort. (To make market rigging difficult, U.S. law prohibits explicit collusion.) The theorists have been most successful in demonstrating that a large number of forces affect actual outcomes in imperfectly competitive markets. The possibilities have been shown to be too complex to permit predictions of whether a given situation is unsatisfactory. Therefore, it has not proved feasible to develop satisfactory indexes of the net effect of these forces. Some economists suspect there is a critical lack of tools for quantifying the entrepreneurial attitudes that play a large part in determining whatever competition or monopoly prevails in an industry.

Even when products are distinct, many questions arise about the geographic extent of markets. National data may either overstate the degree of monopoly by ignoring international competition or understate it by ignoring the isolation of some local businesses from external competition.

In short, the vigor of competition is generally difficult to determine and cannot in any case be deduced from analyzing something as simple as concentration ratios. Congress has therefore refrained from setting allowable concentration ratios in existing industries.

Economists and attorneys remain divided about the net social contribution of antitrust policies outside the price-fixing area, although there seems to be general agreement that price-fixing should be prohibited because it produces a monopolistic restriction of output without leading to more efficient production. But it is far less clear that policies to prevent mergers or to dismantle existing companies are socially beneficial. The legal action necessary to accomplish either of these goals is quite expensive for both parties. At best, the benefits may be small, and in cases where superior firms are sued to protect weaker ones, the outcome is likely to be harmful to society as a whole.

Although these views suggest a lack of enthusiasm for the DOJ guidelines and preference for eliminating the limits on total leasing and holding periods, there remains the question of what is optimal, given existing policy. The next chapter discusses that problem.

5

An Assessment of the Leasing Guidelines and Their Rationale

To develop its guidelines, the Department of Justice (DOJ) had to deal first with the issues of the extent to which different fuels compete and the geographic extent of markets. The department shared the concern raised by the Federal Trade Commission (FTC) about the fact that coal buyers generally seek a unified block of reserves to meet a long-term need for coal. Adequate competition, according to the Justice Department, should be defined in terms of whether control over reserves is sufficiently dispersed among numerous firms.

Overall, the guidelines are built upon a long chain of assumptions, many of which the department itself recognizes are open to question. We may begin with the most basic point first. At best, the department's guidelines establish the product-line, geographic, and reserve-availability dimensions of the market.

No one would dispute the need to determine whether a monopoly was developing in the relevant markets, whatever they may be. But the 10 and 15 percent ratios selected, as noted, have no basis in economic theory or empirical analysis. Thus, an arbitrarily selected ratio, even if applied to a correctly defined market, cannot determine if inadequate competition exists. The Justice Department, in effect, has sought a crutch on which to lean instead of simply deciding to monitor developments within the industry.

In its report the department itself notes the imperfection of concentration ratios as a measure. This point is almost lost, however, by the end of the report. The use of ratios becomes even more undesirable when questions about the adequacy of market definition are raised.

Before examining the key steps the DOJ's argument for the creation of guidelines, it may be useful to examine the state of the general debate over competition in energy. By now a vast literature

has accumulated that discusses the extent of competition in U.S. energy industries, but there is no consensus on the issue. All the contentions that monopoly exists that I have encountered, however, appear in loosely structured discussions usually reflecting a distrust of business.[1] Any study that has taken a more analytic approach has concluded that coal and the other U.S. energy industries are highly competitive.[2] A better case for the existence of monopoly might be made, but the well-publicized efforts, such as those by Blair and Engler, have not provided it.

The inability of the analyses that disprove the existence of monopoly to attract attention, let alone convince people, suggests that formidable barriers exist to reducing public apprehensions about the possible existence of energy monopoly. These public apprehensions continue to exist despite the regularity with which agencies such as the DOJ, the FTC, and the General Accounting Office (GAO)—whose biases, if any, lie in seeking to maximize the problem of monopoly—conclude that it does not exist in the coal industry.[3]

The studies intended to prove the existence of monopoly rely primarily on hunches that the facts needed to prove their case are simply hidden by energy producers and their allies. In short, these studies contend that all of their suspicions about secret behavior within an industry must be refuted before the industry can be considered competitive. Given such a standard, any study that asserts the existence of vigorous competition can be dismissed as having failed to search thoroughly enough.

For present purposes, however, settling the debate conclusively is irrelevant. The critical consideration is that the DOJ's 1978 appraisal concluded that the coal industry was a vigorously competitive

[1] See U.S. Tennessee Valley Authority, *The Structure of the Energy Markets: A Report of TVA's Antitrust Investigation of the Coal and Uranium Industries* (Knoxville, 1977), and *The Structure of the Energy Markets: A Report of TVA's Antitrust Investigation of the Coal and Uranium Industries, 1979 Update* (Knoxville, 1979); John W. Wilson, "Report to the Director, Bureau of Competition, Federal Trade Commission, on 'Report to the Federal Trade Commission on the Structure of the Nation's Coal Industry' and 'Report to the Federal Trade Commission on Competition in the Nuclear Fuel Industry' " (Washington, D.C.: J. W. Wilson and Associates, 1978); John M. Blair, *The Control of Oil* (New York: Pantheon Books, 1976); and Robert Engler, *The Brotherhood of Oil* (Chicago: University of Chicago Press, 1977).

[2] See Thomas D. Duchesneau, *Competition in the U.S. Energy Industry* (Cambridge, Mass.: Ballinger, 1975), passim, footnote 7, and the references in footnote 30.

[3] U.S. Department of Justice, *Competition in the Coal Industry, 1978*, passim; Federal Trade Commission, *Structure of the Nation's Coal Industry*, passim; and U.S. General Accounting Office, *The State of Competition in the Coal Industry*, 1977.

industry. The 1978 study is the most comprehensively developed of the four appraisals of extensive statistical analyses of the coal industry undertaken by the FTC. The other three reviews include two by the FTC itself—one a draft report made available under the Freedom of Information Act and the other in the final FTC report—and one by the GAO.

Only the Justice Department report explicitly considers the question whether coal competes in a broader market that includes other fuels. The DOJ conclusion is that oil and natural gas are poor substitutes for coal but that some competition is offered by uranium. Doubts are expressed about the strength of this competition, however.

Two questions may be raised about the DOJ document. One concern of interest to the policy-making process is whether the department's estimate of oil and gas competition was valid. A more critical concern is the department's handling of competition between coal and nuclear power, since, in fact, the coal-leasing guidelines assume significant linkages between producers in the two fields.

The massive increase in oil and natural gas prices during the 1970s, which decreased the ability of these fuels to compete in the major markets for coal, and the failure of synthetic fuels industries based on coal to emerge have seriously weakened the argument that great substitutability exists among fuels.[4] Even the Tennessee Valley Authority's criticism of oil company participation in the coal industry contains the admission that oil does not compete with coal. The TVA's objections seem to rest on the suspicion that the oil companies will introduce superior skills at price fixing into the coal and nuclear industries.[5]

Although the DOJ report draws conclusions about competition between coal and nuclear power, supporting evidence for those conclusions is virtually absent. The only evidence provided is information on the collective market share in the coal industry of all the firms involved in various aspects of nuclear power and some qualitative statements about the degree of competition in various stages of the process that transforms uranium ore into reactor fuel. This does not tell us whether a few firms control both the coal and the uranium markets. Moreover, the report concludes that the position of nuclear-industry companies in the coal industry is too small to influence coal competition significantly and that no evidence exists that coal supplies have been withheld by nuclear or oil companies.

[4] See Thomas D. Duchesneau, *Interfuel Substitutability in the Electric Utility Sector of the U.S. Economy* (staff report to the Federal Trade Commission), 1972.

[5] See TVA, *Structure of the Energy Markets*, both reports.

What should also be noted is that an FTC report on the uranium industry concluded that concentration in that industry was not a serious problem and that there were few barriers to entry.[6] My own examinations of the uranium market in 1979 and 1980 suggest that prior studies understate, if anything, the potential for competition in uranium production. Numerous companies at home and abroad are ready to enter the uranium mining industry if the demand for new nuclear power plants improves.

The DOJ appears to accept this view and indicates that the problem lies in the stages of the process of converting uranium ore into reactor fuel. The two "bottleneck" states it cites are conversion and fuel-rod fabrication. Uranium is milled into a metal, but for the types of reactors used in the United States, the metal's content of U_{235} must be increased by enrichment. Before enrichment, therefore, the metal is converted into uranium fluoride Only two firms, Kerr McGee and Allied Chemical, are engaged in conversion. After enrichment (a sector monopolized by the federal government), the enriched uranium must be enclosed in fuel rods for use in reactors. This kind of work is done by Exxon, by Gulf, and by four reactor manufacturers —General Electric, Westinghouse, Babcock and Wilcox, and Combustion Engineering.

It is inferred that these firms may have some degree of monopoly of power and thus their position in coal should be limited. Of these eight companies, however, only Kerr McGee, Exxon, Gulf, and General Electric are, in fact, engaged in coal production, and no data are provided to demonstrate that they have excessive shares of the market. Moreover, the Justice Department report fails to indicate whether the limited competition in the "bottleneck" areas is a problem or merely reflects the small size of the nuclear fuel industry.

The next issue is how to define the geographic scope of markets. The uranium market is worldwide, since transportation costs are so insignificant a part of uranium prices that mines with sufficiently low costs can compete anywhere in the world. The geographic scope of coal markets is local, however, and thus we are talking about competition between the world uranium market and local coal markets. To the extent that there is little coal-uranium competition, we may simply look at coal market structure, which is what the Justice Department did: it never considered the combined market, but it did examine the structure of the coal industry.

[6] See Joseph P. Mulholland, John Haring, and Stephen Martin, *An Analysis of Competitive Structure in the Uranium Supply Industry* (staff report to the Federal Trade Commission), 1979.

The DOJ's choice of market definitions seems to have been greatly affected by the FTC report, but the conclusions of the FTC and the GAO on the subject provide a contrast to the DOJ's policy posture. The FTC argued that originally there had been three main markets, those for Appalachian coal, Illinois basin coal, and western coal (largely in the Great Plains). But the FTC found that the penetration of western coal into the market for Illinois basin coal had created a combined Great Plains–Illinois basin market. The GAO accepted this view with the qualification that the southwestern portion of the western industry might be considered an isolated subsector.

The DOJ's position is that it is preferable to consider the Great Plains and the Illinois basin separate markets and to evaluate the Southwest separately. (That evaluation concludes, as did the GAO, that no problem exists in the southwestern coal market.)

The critical question is why the DOJ did not agree with the FTC and the GAO about the fusing of the Great Plains and Illinois basin into a single market. Some parts of the report suggest that the DOJ's position was based on a desire to show that even with a narrow definition of the market no evidence of anticompetitive conditions could be observed. Other comments suggest genuine doubts about a combined Great Plains–Illinois basin market, and the policy proposals are based on the implicit conclusion that the two regions do not strongly compete with each other. Thus, it is essential to decide whether the DOJ correctly determined the geographic scope of the coal markets.

The evidence for a combined Great Plains–Illinois basin market is that competition in the Midwest between Great Plains and Illinois basin coal producers is evident. The producers in the plains have so effectively captured the market in Minnesota—a market once predominantly served by Illinois basin coal—that Minnesota was treated by the DOJ as part of the market for the plains states. Furthermore, Montana and Wyoming coal was being used extensively in Illinois and Indiana. In 1978, 10.9 million of 33.0 million tons of coal delivered to electric utilities in Illinois came from Wyoming and Montana. In Indiana, 3.7 million of 30.5 million tons came from those two western states.[7]

The DOJ contention that the relevant market is the Great Plains in isolation seems to center on its interpretation of the debate inspired by Elzinger and Hogarty's proposed tests of whether regions are

[7] U.S. Department of Energy, Energy Information Administration, *Cost and Quality of Fuels for Electric Utility Plants—1978*, 1979, pp. 37–38.

linked.[8] Elzinger and Hogarty suggest that one should look at both imports and exports (with both terms defined, as in regional economics, to denote flows between areas rather than the narrower concept of flows only among countries). Interactions can occur either through importation of a commodity to a region or through exports to another region.

The DOJ expresses fears, however, that the inclusion of exports will overstate competition and that emphasis should be placed on imports. Parker and others oppose that argument on grounds that the exclusion of exports clearly omits important information about the scope of the market.[9] To state their case somewhat differently, the stronger of two regions of supply can be expected to have many exports and no imports. Customers will buy the coal with the cheapest delivered cost, and the market will be divided between the two suppliers at the point at which delivered prices are equal. By the nature of transportation economics, at every point nearer to, say, the Great Plains supplier than to the point of equal delivered prices, transportation costs will be lower, and customers will buy from the Great Plains supplier. Thus, if the point at which price equalization occurs is in the Midwest, everyone farther west will buy coal from the Great Plains, and it will have no imports.

The DOJ's concern seems to be that it is still possible that the local market could be monopolized by a supplier who would then engage in price discrimination, that is, a higher price for local sales than for export sales. This concern does not have much factual basis.[10] The local market is by far the least important market in long-term potential, and actual conditions are not favorable to discrimination. The degree of competition in the West is so great that coal suppliers fear their profits will prove inadequate. Moreover, customers are alert to market conditions and act vigorously to prevent price gouging by suppliers. Actions of buyers are reenforced by those of regulatory commissions, seeking to control energy costs. Moreover, many coal customers are, in fact, their own coal suppliers.

The interaction between the Great Plains and the Southwest is less clear. Although the potential for competition is considerable, movements of coal from the plains to the Southwest have not oc-

[8] See Kenneth G. Elzinger and Thomas M. Hogarty, "The Problem of Geographic Market Delineation Revisited: The Case of Coal," *Antitrust Bulletin*, vol. 23, no. 1 (Spring 1978), pp. 1–18.

[9] See Scott L. Parker et al., *An Analysis of Aspects of the Department of Justice's May 1978 Report on "Competition in the Coal Industry"* (Washington, D.C.: Management Analysis Center, 1979), pp. 3, 12–23, esp. pp. 14–17.

[10] Ibid., pp. 21, 42–50.

curred. All that has happened so far has been some shipments of both Great Plains and southwestern coal to Texas, but not necessarily to the same parts of the state.[11]

The whole idea of market segmentation may be quite inappropriate in the case of coal. The concept assumes that the only possible interactions are strong ones and that weaker interactions should be ignored. In fact, imperfect but important interactions occur to a degree that justifies believing that each part of the U.S. coal industry interacts indirectly with the other parts. The Illinois basin interacts with Appalachia as well as the plains. Just how much competition exists between the Illinois basin and Appalachia is open to question, but all three of the country's leading coal-using utilities—TVA, American Electric Power, and the Southern Company—are positioned so that they can and do buy coal from both Appalachia and the Illinois basin.

The next step in the two FTC reports, the GAO study, and the DOJ report was to provide information on the characteristics of the coal markets. In each case the appraisal was built primarily upon data assembled by the FTC on both the structure of the coal industry and the characteristics, such as the ability to acquire capital, that affect the ability to compete. Emphasis was placed on appraising the data on market shares, and each evaluation begins with a presentation of the conventional figures dealing with shares of production.

The FTC argued, however—and the DOJ and the GAO agreed—that the nature of the coal market was such that the conventional measures were not the most relevant. The FTC argued that coal mine development had become oriented toward supplying the needs of a specific customer over extended periods of time, such as the thirty-year useful life generally assumed for an electric power plant. Therefore, competition was best measured in terms of the number of suppliers available to serve new demands.

This led the FTC to develop the concept of shares of what may be called uncommitted available reserves. Reserve holdings of individual firms were related to total reserves that were not committed to any customers but had been made available to coal producers. The FTC considered unleased federal coal to be unavailable reserves.

My stated view that market share data of any sort are imperfect indicators of the vigor of competition implies that no good basis exists for appraising the data discussions in the reports. The important point to note is that the original FTC report, the GAO report, and the DOJ report all conclude that the evidence suggested that the coal industry was highly competitive and was likely to remain so, at least if the

[11] See Energy Information Administration, *Cost and Quantity of Fuels*, pp. 36–41.

leasing moratorium were ended. The final FTC report slightly muted the agency's views about the vigor of competition but on balance saw no great threats.

All the reports tend to overemphasize the market share data. In the DOJ report, the overemphasis was carried a step further by basing policy on the data on uncommitted reserve shares. The DOJ analysis should have been limited to the argument that the market share data and all other information implied that a highly competitive coal industry existed.

Applying the guidelines to uncommitted reserves is a particularly difficult task. Substantial uncertainties exist about the size of both the numerator and the denominator of market share fractions.

The DOJ points out that the U.S. Bureau of Mines estimate of demonstrated reserves has two major defects. The bureau's criteria for inclusion are criticized as exaggerating the amount of coal available at costs low enough to make the coal competitive, either today or at some time within the next several decades. Furthermore, the reserve base may be greatly understated because of incomplete geological assessment. The exclusion of at least the federal coal expected to be made available during the time over which the reserve holdings would be committed may have been appropriate for preparing estimates of the worst possible levels of concentration, but it seems inappropriate to ignore the role of such leasing in setting policy designed to guide leasing. Others would argue that all federal coal should be included, since it all could be leased if the desire to increase competition was strong enough.[12] But the DOJ argues that so long as it must set policy in a world of limited leasing in which a commitment to release federal coal to promote competition does not exist, coal unlikely to be leased must be ignored. Moreover, the Justice Department and the FTC, upon whom the DOJ depended for data, were concerned that their analysis might begin with an inadequate denominator.

The numerator also has defects, however. If the companies used the Bureau of Mines criteria, questions would arise about the economic position of company reserves. But Department of Energy discussions, confirmed by my discussions with industry sources, indicate that coal owners do not calculate reserves using those criteria.[13] Thus, it is clear that the FTC ratios are error-prone, but we cannot be sure whether the ratios are too high or too low.

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[12] See Parker et al., *An Analysis*, pp. 34–35.

[13] See U.S. Department of Energy, Energy Information Administration, *EIA Symposium on Coal Resources/Reserves Information*, 1980, esp. pp. 128–45.

The most favorable situation for accepting the FTC ratios at face value occurs when the economic quality of the reserves held by each firm has the same distribution as the demonstrated reserve base, the firm reports demonstrated reserves using Bureau of Mines criteria, and the demonstrated reserve base is measured correctly. The problem of overstating the reserve base thus becomes irrelevant, since an exactly offsetting overstatement occurs with each firm's holdings.

Departures from these baseline assumptions can bias the results in either direction. To the extent that reserves as reported by the companies are better in quality than those in the reserve base, the shares are understated. Conversely, if company reserves are worse in quality and perhaps defined by a more generous inclusion standard than that of the Bureau of Mines, the shares are overstated. Understatement of total reserves leads to overstatement of shares. I would conjecture that the most probable situation is an overstatement of shares because of overestimates of company reserves and underestimates of total western coal resources.

Commitments to sell coal differ markedly. A mine supplying an existing facility is highly committed. At the other extreme, however, a tentative reservation of coal for synthetic fuel production may change at any time to a sale of the coal to more immediate customers.

Any attempt to determine the degree of the various types of commitments is complicated by a lack of data. The FTC survey used only information on the commitments of reserves by surveyed companies, leaving unknown the status of a substantial amount of coal. The FTC indicated that the reasonable range of assumptions was from stating that none of the unsurveyed coal was committed to stating that the proportional commitment of unsurveyed coal was equal to that of surveyed coal. The premise for the upper limit is that, by the very nature of the survey process, those companies that were included were those most likely to have made commitments. Thus, the excluded companies could not have commitment ratios higher than the included ones. The DOJ adopted the assumption of equal commitment of both reported and unreported reserves by owners to ensure conservatism in its analysis.

Thus, the key defects of the DOJ guidelines are that they use debatable and probably unduly restrictive definitions of the relevant market and rely on defective measures of the shares of uncommitted coal held.

The railroad restrictions are similarly illogical. Here, the guiding viewpoint is that transportation supply is restricted to produce monopoly prices but that rail rates cannot be raised to the monopoly price because of rate regulation. The railroads can, however, mine and

sell coal at a price that includes the monopoly profits that would be produced by restricting transportation supply. What the Justice Department fails to consider is how the railroads could monopolize the coal supply to reap these profits.

At this point, it is necessary to return to the question of guidelines for companies in the bottleneck stages of nuclear power. It has already been argued that the DOJ did not provide any factual basis for its concern. The present discussion examines the theoretical arguments presented by the DOJ.

The department presents two special theories of monopoly—"kickback" and "withholding." In both cases the basic concept is that a market exists that involves competition among the producers of two or more different commodities. Economic theory would predict that price rigging would occur only if a firm or closely knit group of firms held a large share of the combined market for these commodities. The only possibility of large shares is through substantial participation in the production of one commodity (and little production of the other) or through significant production of several of the linked commodities.

On close examination, the concept of the kickback turns out to be nothing but a special name for market power consisting principally of participation in the production of one commodity. Withholding is a similarly unneeded term for power through participation in the production of several commodities.

A particularly weak point in the DOJ theory of kickback monopoly is the version in which there is monopoly in one industry and competition in the other. Norman suggested that if this were the case, actions in the competitive industry would undermine any efforts at monopolizing the other industry.[14] The problem seems to be the proper interpretation of just what the DOJ meant by competition in the other industry. If we take the department literally and assume unlimited freedom of entry in one sector, Norman's conclusion will be the proper one. The Justice Department's argument can be "saved" only by asserting that competition means lack of market power by existing firms but limited freedom of entry. This is a curious definition of competition.

Indeed, John H. Shenefield, then assistant attorney general in charge of the DOJ antitrust division, has noted that "increased demand for coal would have little effect on coal prices" because the

[14] See Donald Norman, "Competition in the Coal Industry: Review and Critique" (Washington, D.C.: American Petroleum Institute, 1978).

suppliers are so numerous.[15] Shenefield stated this when opposing the application of the kickback (or withholding) theory to oil company participation in the coal industry. The contention also applies to the use of the kickback theory to rationalize special rules for nuclear companies. Shenefield's statement suggests that the DOJ's faith in the applicability of its kickback and withholding theories to coal is not sufficient to justify special limits for companies in the bottleneck stages of uranium processing.

What, then, is justified? I would argue for nothing more than careful governmental monitoring of competition in the coal industry and governmental intervention when positive evidence is obtained that firms are accumulating excessive shares of truly marketable reserves.

The DOJ may argue that legal precedents compel it to adopt stringent guidelines, but the evidence cited above suggests that available data are grossly inadequate for constructing a mechanistic approach to the regulation of leasing. I can see no reason why the DOJ should not be content with stringent enforcement on a case-by-case basis. The law, it may be recalled, calls for review of specific leases. The guidelines would simply make review easier for the DOJ. This limited benefit would come at the cost of adding still another impediment to the expeditious development of energy production. In short, the cost would undoubtedly exceed the benefits.

[15] See the processed version of his "Testimony Before the Subcommittee on Energy and the Environment of the Committee on Interior and Insular Affairs, United States House of Representatives, Concerning H.R. 8, the Public Energy Competition Act," 1979.

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